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Double Taxation/Fiscal Evasion and International Tax Treaties

Oscar M. Trelles, II*

I. INTRODUCTION

Taxation in its original concept was free from international complications. Taxes were imposed against land, ignoring questions of sovereign disputes of ownership, and were collected by only one sovereign, against land under his rule or jurisdiction.

As the basis for taxation has changed and centered on the person rather than the land, problems of dual tax liability as well as fiscal evasion have increasingly become, *inter alia*, a troublesome aspect of the tax administrative process. An individual or other legal entity residing or doing business in a foreign area is subjected to possible tax liability by both the foreign state and the home country. At the same time, the state is hindered in its attempt to collect a tax if a person is able to leave the jurisdiction with all his assets while intending never to return. This Article will deal with these two problems; and, specifically, with the solutions attempted through international agreements.

Basically, the reason for turning to international agreements in extending the reach of a state's fiscal system is that, as Lord Mansfield stated: "[O]ne nation does not take notice of the revenue laws of another" (the "notice" doctrine).¹ This barrier to an alien tax authority is so well established that it is categorized as one of the fundamental rules of international law.² Its proponents have stressed the analogy to criminal law, whereby any imposition is deemed an attack on a state's sovereignty.³ It is further contended that unilateral provisions can best handle the problem of double taxation, and that allowing foreign jurisdiction in evasion cases may place the court in the embarrassing position of either applying or striking down a tax considered to be contrary to public policy.⁴ Opponents of

*B.A., Instituto de Matanzas (Cuba), 1957; Licenciado en Derecho Diplomatico, University of Havana, 1962; M.A.L.S., University of Toledo (Ohio), 1975.

¹Planche v. Fletcher, 99 Eng. Rep. 164, 165 (K.B. 1779).

²Leflar, *Extrastate Enforcement of Penal and Governmental Claims*, 46 HARV. L. REV. 193, 215-23 (1932).

³*Id.* at 219.

⁴Moore v. Mitchell, 30 F.2d 600, 604 (2d Cir. 1929) (Hand, J., concurring).

this ancient doctrine have asserted that no analogy can be made between criminal and tax law because criminal laws are punitive, whereas taxes are imposed as a social obligation.⁵ They argue that unilateral solutions to double taxation are collateral and cause as many problems as they attempt to solve.⁶ Lastly, opponents ask balancing of the stigma of striking down a foreign law against the stigma of affording delinquent taxpayers sanctuary.⁷ Regardless of the arguments, the question is whether the "notice" doctrine is merely judicial tradition without substance or a meaningful and necessary rule of international law. If it is the former, then treaty activity would seem a necessary solution.

This Article will analyze the problem in three sections: It will discuss the relevance and advisability of including both areas of tax administration, i.e., double taxation and tax evasion, in the same treaty negotiations and documents, and then will examine these two areas separately, analyzing the special microcosm of considerations imposed by each.

II. ADVISABILITY OF COORDINATING DOUBLE TAXATION AND FISCAL EVASION PROPOSALS

While still in their infancy, international tax conferences created awareness of the need to consider the two basic problems of tax negotiations within the same basic framework. The best demonstration of the validity of this conclusion comes from the first attempt of the League of Nations at tax negotiations in 1920 to the resulting treaties of 1939 to 1946.⁸

A. *Work of the League of Nations and Development of the O.E.C.D.⁹*

Shortly after the International Financial Conference of 1920, a recommendation was made to the League of Nations that it consider the question of double taxation. The International Economic Conference, which had met in 1922, recommended that the League also examine the problem of fiscal evasion. This latter task, investigating the question of fiscal evasion, was entrusted to a group of high of-

⁵See Eichel, *Administrative Aspects of the Prevention and Control of International Tax Evasion*, 20 U. MIAMI L. REV. 25, 71-73 (1965).

⁶Leflar, *supra* note 2, at 221.

⁷Eichel, *supra* note 5, at 72-73.

⁸See King, *Fiscal Cooperation in Tax Treaties*, 26 TAXES 889 (1948).

⁹This discussion is based on an analysis of King, *supra* note 8, at 889; and of A. VAN DEN TEMPEL, RELIEF FROM DOUBLE TAXATION 7-24 (International Bureau of Fiscal Documentation, Developments in Taxation Since World War I No. 7, 1967); as well as reference to certain League of Nations and O.E.C.D. reports as cited below.

ficials from the fiscal administrations of seven European countries, the Committee of Technical Experts. On the basis of resolutions submitted in 1925 to the League's Financial Committee,¹⁰ the League Committee soon submitted to the Council of the League a report containing four model bilateral conventions.¹¹ The first model convention pertained to the elimination of double income taxation, the second to the elimination of double succession duties, the third to the exchange of information, and the fourth to reciprocal assistance in the collection of taxes. By 1928, the models had been circulated to the various governments, and in October 1928, the models were discussed and revised. Pursuant to a request that a permanent committee be formed, the Council of the League named a Fiscal Committee¹² which: (1) Drafted a model convention on allocation of business profits,¹³ and (2) revised the model conventions of 1928, incorporating the 1932 draft.¹⁴

Until the formulation of these two model conventions, the vast majority of taxation treaties were deficient in most areas, and unable to be reconciled with other treaties. The promulgation of the Mexico and London models brought some semblance of uniformity to the bilateral conventions executed in the post-war period, but there still were a large number of differences in the provisions of existing treaties,¹⁵ resulting in considerable uncertainty for taxpayers doing business in foreign countries. This impediment to international com-

¹⁰*Report and Resolutions Submitted by the Technical Experts to the Financial Committee of the League of Nations*, L.N. Doc. No. F. 212, 10-30 (1925) [hereinafter cited as L.N. 1925].

¹¹*Report Presented to the Financial Committee of the League of Nations by the Committee of Technical Experts on Double Taxation and Tax Evasion*, L.N. Doc. No. C. 216. M. 85., 5 (1927) [hereinafter cited as L.N. 1927].

¹²*See Resolutions Adopted by the Council at its Fifty-Third Session*, L.N. Doc. No. C. 613. M. 190. (1928).

¹³The convention was drafted after an inquiry in many countries, the results of which were published in 1932-1933. *Taxation of Foreign and National Enterprises: 1, France, Germany, Spain, the United Kingdom, and the United States of America*, L.N. Doc. No. C. 73. M. 38. (1932); *Taxation of Foreign and National Enterprises: 2, Austria, Belgium, Czechoslovakia, Free City of Danzig, Greece, Hungary, Italy, Latvia, Luxembourg, Netherlands, Roumania, and Switzerland*, L.N. Doc. No. C. 425. M. 217. (1933); *Taxation of Foreign and National Enterprises: 3, British India, Canada, Japan, Mexico, Netherlands, Indies, Union of South Africa, States of Massachusetts, New York, and Wisconsin*, L.N. Doc. No. C. 425(a). M. 217(2). (1933), discussed in Carroll, *International Tax Law; Benefits for American Investors and Enterprises Abroad*, 2 INT'L LAW. 692, 703 n.20 (1967-1968).

¹⁴The model conventions of London were published together with the models established during the war by a group of members of the League of Nations meeting in Mexico. These latter models came to be referred to as the Mexico City Convention (1943) and the London Convention (1946). Carroll, *supra* note 13, at 707.

¹⁵A. VAN DEN TEMPEL, *supra* note 9, at 13.

mmercial transactions prompted the creation of the Fiscal Committee of the Organization for European Economic Cooperation (O.E.E.C.) by the O.E.E.C. Council in 1956 to study fiscal questions relating to double taxation and tax collection.¹⁶

The committee initially took as a major objective that of drafting a series of treaty articles which could be used as a model bilateral convention with the hope that the adoption of these articles by a large number of countries would eventually lead to the adoption of a single multilateral convention.¹⁷ When the Organization for Economic Co-operation and Development Fiscal Committee (O.E.C.D.) was formed with members from the O.E.E.C. countries, plus the United States and Canada,¹⁸ the Fiscal Committee continued and, in 1963, completed the report on the Draft Double Taxation Convention. This report was the culmination of the study reports issued in 1958, 1959, 1960, and 1961. It brought together in one publication the basic materials contained in these reports and the complete text of the Draft Double Taxation Convention.¹⁹ The Fiscal Committee and its successor, the Committee on Fiscal Affairs, met regularly and issued a number of other study reports relating to the problems of double taxation and tax enforcement.²⁰ More significantly, the committee has recently completed its Model Double Taxation Convention on Income and on Capital.²¹

B. Coordination of Treaty Provisions

In determining the most effective approach towards international agreements a decision must be made as to whether the collec-

¹⁶Organization for Economic Cooperation and Development Fiscal Committee, Report, *Draft Double Taxation Convention* 7 (1963) [hereinafter cited as O.E.C.D. Report]. The outstanding work carried out by the League of Nations against double taxation over a 25-year period (1921-1946) was resumed in 1956 with the creation of the Fiscal Committee of the O.E.E.C. (later O.E.C.D.). Although the League had hoped for the Fiscal Committee of the United Nations to continue its efforts on the subject, this Committee did not produce much at all in regard to the drafting of model conventions during its short existence.

¹⁷O.E.C.D. Report, *supra* note 16, at 10.

¹⁸A. VAN DEN TEMPEL, *supra* note 9, at 11.

¹⁹O.E.C.D. Report, *supra* note 16, at 41-58.

²⁰E.g., COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., THE TREATMENT OF FAMILY UNITS IN O.E.C.D. MEMBER COUNTRIES UNDER TAX AND TRANSFER SYSTEMS (1977); COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., THE TAX/BENEFIT POSITION OF SELECTED INCOME GROUPS IN O.E.C.D. MEMBER COUNTRIES, 1972-1976 (1978); FISCAL COMMITTEE, O.E.C.D., FISCAL INCENTIVES FOR PRIVATE INVESTMENT IN DEVELOPING COUNTRIES (1965); COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., THE TAXATION OF COLLECTIVE INVESTMENT INSTITUTIONS (1978).

²¹COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., MODEL DOUBLE TAXATION CONVENTION ON INCOME AND ON CAPITAL (rev. ed. 1977) [hereinafter cited as O.E.C.D. MODEL TREATY].

tion provisions should be made an integral part of a comprehensive treaty which contains the substantive provisions concerned with the problem of double taxation, or whether these provisions should be considered as separate and distinct treaties. The following is a list of the considerations, for the most part suggested by the League's work, necessary in deciding whether to correlate and, if so, how to correlate the problems of double taxation and collection.

1. *Both problems are responsive to the concerns of the taxpayers and governments involved.*—Although it might first be said that this close relationship between double taxation and fiscal evasion weighs on the side of the more comprehensive treatment, the Committee of Experts reasoned:

Taxpayers, alarmed by proposals for fiscal control do not understand why, before or during the framing of measures which may prove embarrassing to them, States do not come to some agreement in order suitably to define their respective jurisdictions as regards taxation, and to avoid taxation. On the other hand, if States, in concluding agreements to avoid double taxation, are given to make sacrifices in the matter of the yield from taxation, owing to the granting of exemption, or relief, or reduction of the rates of their taxes, etc., they may properly endeavor to find compensation for what they thus surrender in measures against tax evasion.²²

Thus, the greater the administrative reach, the more concern with double taxation by the taxpayer; the greater the relief from double taxation, the greater the desire of government to extend its administrative reach. This conflict between the two is best reconciled, it would seem, by dealing with double taxation and fiscal evasion together.

2. *Having a thorough knowledge of the other country's tax system is necessary in working with both problems.*—Opponents of these collection measures have complained that not enough is known about the foreign tax system to which one government measures part of its collection process.²³ In working out the substantive provisions on double taxation, each country must, of necessity, study in some detail the tax system of the other. Thus, collection provisions emerging from an informative exchange between the taxing authorities become less amenable to attack on the basis of a lack of knowledge of the foreign taxing system.

²²L.N. 1925, *supra* note 10, at 27.

²³See Report to the Council on the Work of the Eighth Session of the Fiscal Committee, L.N. Doc. No. C. 384. m. 229., 1-2 (1938).

3. *Both problems contain equitable concerns.*—The League's Committee of Technical Experts saw the connection as mainly a moral one.²⁴ The League considered the goal of both types of provisions to be the equitable distribution of tax burdens between taxpayers and governments. Therefore, separate treatment, allowing the possibility of a one-sided approach, would lessen the chances of achieving this goal. Stated in another way, the problem could have been viewed as achieving an equitable distribution of tax burdens and revenues. The most complete means towards equitable results calls for both the prevention of fiscal evasion and relief from double taxation.

4. *A causal relationship exists between the two problems.*—Notions expressed by the League as to the causal effect the two problems might have on each other support the side of the two-pronged, single-treaty approach.²⁵ There were three aspects to this causal connection. First, the decrease in double taxation caused a decrease in fiscal evasion:

Double taxation, which affects many undertakings and persons who exercise their trade or profession in several countries, or derive their income from countries other than the one in which they reside, imposes on such taxpayers burdens which, in many cases, seem truly excessive, if not intolerable. At the same time, any excessive taxation, by its very burden, brings in its train tax evasion: . . . the suppression of double taxation is therefore closely connected with the measures for the systematic prevention or checking of such evasion.²⁶

Second, assistance in matters of fiscal evasion often caused an increase in double taxation; however, this might be remedied by dealing with both problems together. In an early report, the Committee felt that a provision aimed at controlling fiscal evasion would increase "the mischievous consequences of double taxation on account of the conflict of laws in respect of domicile,"²⁷ but continued:

To this objection . . . it may be replied that the proposed resolutions (referring to its 1925 Resolutions on Double Taxation and Tax Evasion) form an indivisible whole, and that their object is to prevent both double taxation and tax eva-

²⁴See L.N. 1925, *supra* note 10, at 28.

²⁵L.N. 1927, *supra* note 11, at 8.

²⁶*Id.* at 8-9.

²⁷L.N. 1925, *supra* note 10, at 25.

sion. The foregoing criticism will be seen to furnish fresh proof of the close connection between the two problems.²⁸

The third aspect of this relationship arises in the context of double taxation treaties which give special benefits to the signatory states as a means of dealing with double taxation. The measures aimed at fiscal evasion in this context have quite a narrow application because their need is due solely to the double taxation provisions. The League realized this development when it concluded:

On the one hand, conventions suggested for avoiding double taxation may contain special measures against evasion, destined to prevent any abuse arising from their application; on the other hand, the exchange of information may perhaps lead to duplication in the levying (or collecting) of taxes. This is tantamount to saying that, in elaborating any practical measure for dealing with one of these problems, account must also be taken of the other.²⁹

5. *Collection provisions may reimburse a government for the loss from double taxation provisions.*—Effective measures of collection assistance are a means to reimburse countries for the loss of revenue sustained from the double taxation provisions. Provisions concerned with fiscal evasion might cushion the loss in revenue caused by double taxation provisions, and, therefore, provide an incentive for more nations to enter such agreements.³⁰

6. *Double taxation provisions may carry the collection provisions past taxpayer disapproval.*—Because governments must, in many instances, bend to the will of their taxpayers, a point of government strategy is the ability to enhance taxpayer reception of collection provisions. Taxpayers, mindful of the benefits received from double taxation provisions, would be more receptive to a comprehensive treaty with inseparable collection provisions.³¹ Coordination between the two problems may also meet the criticism that collection provisions interfere with the free flow of capital inasmuch as double taxation, which aids the flow of capital, tends to counteract any inhibiting effects that the collection provisions may have.

7. *A double taxation provision insuring equality of treatment helps meet the taxpayer's fear of abandonment to the collection pro-*

²⁸*Id.*

²⁹*Id.*

³⁰*Id.*

³¹*Conventions with South Africa, New Zealand, Norway, Ireland, Greece, & Canada on Double Taxation: Hearings Before a Subcomm. of the Comm. on Foreign Relations United States Senate, 82d Cong., 1st Sess. 66-67 (1951) [hereinafter cited as 1951 Hearings].*

visions.—Another fear on the part of taxpayers generated by these collection provisions is the State's abandonment of its citizens who are taxable in another country, leaving them entirely at the discretion of a foreign tax administration, and, moreover, putting itself under the obligation to carry out, at the request of such an administration, measures that may not be in harmony with domestic customs.³² However, such a danger is already reduced by the article of the 1946 Model Convention for the Prevention of Double Taxation of Income and Property which relates to equality of treatment.³³

8. *Separate treatment enables administrations to make better use of its few international tax specialists.*—It might be said that, since few nations have a large number of people capable of putting together sophisticated international tax agreements, treaties of the highest quality can be had only if efforts are concentrated on either the problem of double taxation or of tax evasion at any one time. That is, asking the sparse number of international tax people in the administrations of the various governments to work towards a comprehensive treaty may be spreading worthwhile research too thin.³⁴

9. *Separate treatment may avoid delay of the more important double taxation provisions.*—For any number of reasons, a government may be apprehensive of entering into a treaty containing collection provisions. The need for double taxation relief, however, may be of great importance to both countries. Thus, one country pressing for a collection provision may delay the needed double taxation provisions.³⁵ If it were essential that the two be treated together, this country would have to weigh the cost of any delay against the necessity of a collection provision which could not be considered in the future. But if the two might profitably be considered separately, the country desiring the collection provision need not delay.

10. *Separate treatment increases the likelihood of more countries entering into these agreements.*—The less people have to agree on, the sooner they will agree, if they are to come to any agreement at all. Therefore, if these collection provisions are at their best when as many nations at any one time as possible agree to them,³⁶ reducing the treaty to collection provisions only increases the possibility of greater acceptance. This reasoning, of course, ignores the possibility that by adding double taxation measures there

³²London and Mexico Model Tax Conventions, Commentary and Text, L.N. Doc. No. C. 88. M. 88., 46 (1946) [hereinafter cited as L.N. 1946].

³³*Id.* at 68-69.

³⁴See Eichel, *supra* note 5, at 41-42.

³⁵See L.N. 1946, *supra* note 32, at 46.

³⁶See L.N. 1927, *supra* note 11, at 4, 27.

may be increased incentive to enter into such agreements because of the possibility of increased taxpayer approval.

On balance it would seem, as the League concluded, that the weightier arguments favor a comprehensive treatment of the two problems.³⁷ Practical considerations, however, might make this double-barrelled analysis unprofitable and, thus, cause abandonment of the work on collection provisions.

Ultimately, it would seem difficult to ignore these collection provisions because they might prove to be a hindrance to relief from double taxation. This is especially so when one has conceded their importance in attempting to reach the goal of a fair and equitable distribution of tax burdens and benefits between governments and taxpayers.

III. THE PROBLEM OF DOUBLE TAXATION

Basically, double taxation treaties are designed to avoid taxation of a single event or transaction by two or more states. The basic problem of double taxation was recognized by the United States early in its history of income taxation,³⁸ when substantial relief was provided through the foreign tax credit, as well as various other measures.³⁹

Unfortunately, such unilateral solutions have several limitations. Initially, any relief granted is given by business activity, not given

³⁷*L.N. 1946*, *supra* note 32, at 100.

³⁸Revenue Act of 1919, §§ 222, 238(a), 40 Stat. 1073, 1080 (1919) (current version at I.R.C. § 901).

³⁹See I.R.C. §§ 871, 881, 882, 901. The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), introduced various changes in regard to the foreign tax credit, including the denial of the foreign tax credit to a taxpayer cooperating with, or participating in, an international boycott based on nationality, race, or religion. Pub. L. 94-455, § 1061(a), 90 Stat. 1649 (1976) (codified at I.R.C. § 908) and Pub. L. 94-455, § 1064(a), 90 Stat. 1650 (1976) (codified at I.R.C. § 999). In addition, the amount of dividends received from corporations in less-developed countries is now increased by the amount of foreign taxes deemed paid with respect to the dividends by the recipient domestic corporation to the foreign corporation. Pub. L. 94-455, § 1033(a), 90 Stat. 1626 (1976) (codified at I.R.C. § 902). Further, the per-country foreign tax credit limitation has been repealed, requiring the use of the overall limitation to establish the amount of foreign tax paid which can be used to reduce United States taxes. This will have the effect of reducing overall income from sources outside the United States by reducing the amount of foreign taxes which can be used as a credit against United States taxes. Pub. L. 94-455, §§ 1031(a), 1032(a), 90 Stat. 1562, 1620 (1976) (codified at I.R.C. § 904). The foreign tax credit limitation was further adjusted to reflect the lower tax rate on capital gains income received by a corporation. Pub. L. 94-455, § 1034(a), 90 Stat. 1624 (1976) (codified at I.R.C. § 904(b)(2)). Further, the foreign tax credit is now allowed for foreign taxes paid by a third-tier subsidiary. Pub. L. 94-455, § 1037(a), 90 Stat. 1633 (1976) (codified at I.R.C. § 960).

by the individual country.⁴⁰ Consequently, a nation's laws are unable to deal with specific problems. Moreover, any relief granted is often at the expense of the country itself. Every time another country imposes a tax, the United States bears the burden and effectively subsidizes the foreign state.⁴¹ Beyond the benefits of these unilateral devices, the taxpayer is then burdened by a double tax. The only solution to this problem is a bilateral or multilateral agreement between individual sovereigns.⁴²

Unilateral solutions also involve another problematic area. If two countries provide separate relief from double taxation for any given transaction, an individual may escape the tax of both countries. This occurs if both countries have ceded jurisdiction to tax a specific area. This is not likely to occur if the method of relief is a tax credit, but it can easily happen if both countries grant an outright exemption for a particular type of income. Accordingly, bilateral or multilateral agreements are necessary to curb the possibility of this rather different type of tax shelter and to insure that all income is at least subject to some type of tax.

An analysis of any attempt at an international solution to these problems of double taxation encompasses three general areas—the basic scope of the treaties, the basis for allocation of the overall tax base, and, for lack of a better label, the peculiar problems involved in each type of tax base. Due to the infinite number of possible approaches to these three areas, it is necessary to choose some base, even an arbitrary one, on which to center the discussion. Thus, this analysis will center on the Draft Double Taxation Convention prepared by the Organization for Economic Co-operation and Development Fiscal Committee.⁴³

A. Tax Treaty Scope

All United States tax treaties are entered into by the President of the United States and subject to the consent of the United States

⁴⁰I.R.C. § 901 allows the credit for taxes of foreign countries in terms of taxes paid "to any foreign country or to any possession of the United States." (Emphasis added).

⁴¹This is so, because the tax was paid to and collected by the foreign country, and generally, the taxes paid to and collected in the United States are thereby reduced.

⁴²See Ownes, *United States Income Tax Treaties, their Role in Relieving Double Taxation*, 17 RUTGERS L. REV. 428 (1963).

⁴³The O.E.C.D. in April, 1972, published the Revised Text of Certain Articles of the 1963 Draft Double Taxation Convention on Income and on Capital. The Revised Articles and Commentaries reflect modifications of the O.E.C.D. Model Draft of 1963 which member countries have included in various bilateral treaties since publication of the 1963 Draft. Carroll, *United States Tax Treaties with the European Community Member Countries: Corporate Assets*, 44-3rd T.M. A-19 (1974).

Senate.⁴⁴ Further affirmation of the scope of these treaties is found in the Internal Revenue Code: "Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle."⁴⁵

Yet, this seeming subjugation of the Code to international treaties is not at all binding on the interpretation of provisions in a convention or treaty. The Supreme Court of the United States seems to broadly interpret provisions in treaties, while still reserving the power to limit any such provision that may cut too deeply into the intent of the Internal Revenue Code. Compare the opinion of the Court in *Hauenstein v. Lynham*:⁴⁶ "Where a treaty admits of two constructions, one restrictive as to the rights, that may be claimed under it, and the other liberal, the latter is to be preferred"⁴⁷ with its recent limitation in *Maximov v. United States*:⁴⁸ "To say that we should give a broad and efficacious scope to a treaty does not mean that we must sweep within the Convention what are legally and traditionally recognized to be domestic taxpayers not clearly within its protections . . ."⁴⁹

Thus, the courts have a general policy of broad interpretation of treaty provisions, while also maintaining an unpredictable strain of judicial opinion subjugating international conventions to the Internal Revenue Code. In certain areas in which the Code requires strict interpretation,⁵⁰ this can lead to very discordant results. Thus, the first requirement of any tax convention is a very definite delineation of the principles of interpretation.

Clearing the hurdle problems of interpretation, the convention must set out the scope of taxes to be considered. This was discussed in Article 2 of the O.E.C.D. Convention:

1. This Convention shall apply to taxes on income and on capital imposed on behalf of each Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes

⁴⁴U.S. CONST. art. II, § 2.

⁴⁵I.R.C. § 894.

⁴⁶100 U.S. 483 (1880).

⁴⁷*Id.* at 487; *accord*, *Factor v. Laubenheimer*, 290 U.S. 276 (1933).

⁴⁸373 U.S. 49 (1963).

⁴⁹*Id.* at 56.

⁵⁰See *Corn Prods. Ref. Co. v. Commissioner*, 350 U.S. 46 (1955).

on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation⁵¹

What is required is a very specific enumeration of the exact taxes to be included. The Article includes taxes imposed by state and local governments and, thereby, would solve one of the more irritating aspects of the United States tax system. If a nonresident alien works in the United States for a period included within the exemption provisions of an international treaty, it is often financially embarrassing, as well as emotionally disturbing, for the individual to find himself unexpectedly subject to state or local income taxes. Although it has never been specifically determined whether a United States tax treaty is controlling over a state tax law, it appears that such an interpretation would be constitutional.⁵² The United States, however, has reserved its position on this part of the Article, probably based more on political considerations than on constitutional authority.⁵³

A further problem arises in determining the scope of taxes due to the difference in tax bases of foreign countries. Taxes covered in the conventions sometimes include, in addition to income taxes,⁵⁴ capital taxes and taxes on movable property and land.⁵⁵ Because the conventions are intended to be reciprocal, the overall foreign taxes are generally parallel in economic effect to United States income taxes subject to the Treaty.

An additional problem is determining what persons are subject to a treaty. Basically, the persons affected by the conventions are resident individuals of each contracting country as well as corporations or other entities organized under the laws of the contracting state. The term "enterprise" is also referred to with special significance in most of the conventions.⁵⁶ The recipients of benefits in the treaties are almost exclusively nonresidents of the country granting a special status. This is due to a "savings clause," which is almost always included in tax conventions. This clause provides that, to determine the taxes of its citizens, residents, or corpora-

⁵¹O.E.C.D. *Report*, *supra* note 16, at 4.

⁵²Cf. *Missouri v. Holland*, 252 U.S. 416 (1919) (treaty for protection of wild birds not a violation of state's reserved powers under tenth amendment, due to national scope of interest involved and the necessity of a treaty to protect interest).

⁵³O.E.C.D. *Report*, *supra* note 16, at 39-40.

⁵⁴See, e.g., *Convention Respecting Double Taxation*, Apr. 29, 1948, United States-Netherlands, art. I, para. (1), 62 Stat. 1757, T.I.A.S. No. 1855.

⁵⁵See *Convention for the Avoidance of Double Taxation*, Mar. 30, 1955, United States-Italy, art. I, para. (6), 7 U.S.T. 2999, T.I.A.S. No. 3679.

⁵⁶See discussion of the term "enterprise" in O.E.C.D. *Report*, *supra* note 16, at 65.

tions, a country may include all items in taxable income under its laws regardless of treaty provisions.⁵⁷

With the exception of the status of a citizen falling within the "savings clause" category, it is necessary to determine the residence of individuals for purposes of asserting a benefit under a tax treaty. Article 1 of the O.E.C.D. draft provides that the convention applies to residents of one of the contracting countries.⁵⁸ Article 4 defines residency with more particularity than any other United States treaty has done.⁵⁹ An adequate definition becomes more and more important with problems of multiple residences and the consequences of employing an inadequate definition. The draft sets forth various criteria for determining residence. First, the individual is treated as a resident at the location of his permanent home. In the case of multiple permanent homes, the draft chooses the home in which the taxpayer has the closest personal and economic interest ("centre of vital interests"). If there is no permanent home or if the "centre of vital interests" cannot be determined, then his habitual abode is considered his residence. Finally, in cases of multiple habitual abodes, the draft defers to the country of which the taxpayer is a national.⁶⁰ The United States bases tax liability on the basis of citizenship as well as residence.⁶¹ The term "residence" has been defined as related to, but less substantial than, the common law concept of domicile.⁶² Adoption of the draft's definition would certainly assist in bringing about uniformity, but it would allow wealthy United States citizens to establish their principal residence in low tax rate countries and obtain very substantial tax savings. Thus, the United States probably would not enter into a multilateral treaty embodying the residence concept, as demonstrated by its reservation of approval of Article 4. Possibly, however, the United States could apply Article 4 to problematic definitional questions while still retaining the "savings clause" and not derogating the right of the United States to tax its citizens.⁶³

Presently, corporations entitled to benefits under the treaties are generally corporations organized under the laws of the contract-

⁵⁷See *Crerar v. Commissioner*, 26 T.C. 702 (1956) for an explanation of the "savings clause" as well as a validation of the method.

⁵⁸O.E.C.D. *Report*, *supra* note 16, at 41.

⁵⁹*Id.* at 43.

⁶⁰*Id.*

⁶¹I.R.C. § 901; Treas. Reg. § 1.1-1(a). See also, B. BITTKER & L. EBB, UNITED STATES TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS 482 (1968).

⁶²Treas. Reg. § 1.871-2(b) (1971).

⁶³Association International de Droit Financier et Fiscal, Klimowsky, *Unilateral Measures for the Avoidance of Double Taxation*, 43 CAHIERS DE DROIT FISCAL INTERNATIONAL 12 (1961).

ing states. Thus, residence is generally based on origin, rather than principal place of business. The theoretical arguments of defining a corporation are not nearly as great as the practical necessity of obtaining some standard definition. The problem of conflicting definitions is demonstrated by a recent United States-Canadian convention.⁶⁴ A Canadian corporation under the treaty is different from the Canadian corporation under national law. The O.E.C.D. draft convention provides that, if a corporation is subject to taxation in both contracting states, and therefore a resident of both contracting states, it shall be deemed to be a resident of the contracting state in which its place of effective management is situated.⁶⁵ The implementation of this definition would free both countries to adopt broad internal definitions without fear of subjecting a corporation to double tax liability.

In cases of individuals, permanent residence is a tangible concept. Business enterprises, however, are judged on the basis of permanent establishment.⁶⁶

B. Permanent Establishment

One indicator of the residence of a business enterprise is the country in which the enterprise is organized, although it may also have business operations in many other countries. The purpose of the term "permanent establishment" is to determine when the operations subject the enterprise to the taxing authority of a country.

United States treaties have universally adopted and applied the concept of "permanent establishment" as the principal limitation imposed upon the treaty parties to tax income from sources within their boundaries.⁶⁷ For example, it is generally applied to limit taxation of industrial and commercial profits, dividends, interest, and royalties. In essence, the treaty parties agree to exempt certain types of income from taxation, or at least to reduce their tax on such income, if the economic penetration into the source country by the recipient of the income does not constitute a permanent establishment.

Under the Internal Revenue Code, a foreign taxpayer will be subject to United States tax on income from United States sources

⁶⁴*Convention Respecting Double Taxation*, Mar. 4, 1942, United States-Canada, 56 Stat. 1399, T.S. No. 983, as amended, June 12, 1950, art. XII, paras. (1)-(2), 2 U.S.T. 2235, T.I.A.S. No. 2347.

⁶⁵O.E.C.D. *Report*, *supra* note 16, at 41.

⁶⁶A. VAN DEN TEMPEL, *supra* note 9, at 38.

⁶⁷*See id.*

if he engages in a trade or business within the United States.⁶⁸ This concept of "engaged in a trade or business" is carried into the conventions and coupled with the term "permanent establishment." Thus, the test under United States treaties is whether the foreign resident is engaged in a trade or business through a permanent establishment.⁶⁹ Article 5 of the O.E.C.D. draft⁷⁰ contains the definition of a permanent establishment. Specifically, the convention states:

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.
2. The term "permanent establishment" shall include especially:
 - a) a place of management;
 - b) a branch;
 - c) an office;
 - d) a factory;
 - e) a workshop;
 - f) a mine, quarry or other place of extraction of natural resources;

⁶⁸I.R.C. § 882(a) (foreign corporations subject to tax).

⁶⁹Carroll, *Evolution of U.S. Treaties to Avoid Double Taxation of Income, Part II*, 3 INT'L LAW 169 (1968-1969). See also Johansson v. United States, 336 F.2d 809 (5th Cir. 1964); Samann v. Commissioner, 313 F.2d 461 (4th Cir. 1963); Donroy, Ltd. v. United States, 301 F.2d 200 (9th Cir. 1962); Commissioner v. Consolidated Premium Iron Ores, Ltd., 265 F.2d 320 (6th Cir. 1959); American Trust Co. v. Smyth, 247 F.2d 149 (9th Cir. 1957).

⁷⁰O.E.C.D. *Report*, *supra* note 16, at 43. United States treaty definitions of a permanent establishment since 1961 have been largely patterned after the O.E.C.D. draft prototype. Notable changes in the newer treaty definitions include allowing a foreign enterprise to engage in the five O.E.C.D. designated ancillary and preparatory activities, such as delivery and warehousing, without being designated as a permanent establishment. Williams, *Permanent Establishments in the United States*, 29 TAX LAW. 277, 303 (1976). The newer treaties based on the O.E.C.D. Draft have replaced the older treaty view of a permanent establishment, rigidly defined by a concept of fixed assets or specified agencies, with a more functional view toward economic profit and regular business activity deriving from the fixed assets or specified agencies. A fixed place of business, which is used for regular, but ancillary and preparatory activities to the realization of economic profit, such as storage, display, scientific research, and advertising will not be designated as a permanent establishment subject to taxation. The O.E.C.D.-based definitions of permissible "non-permanent establishments" permit a considerably wider scope of activities than the earlier treaties, and illustrate the O.E.C.D.'s evident intent to tax "only those agencies and assets which are continuously used for business activities having an essentially direct relation to the realization of economic profit." *Id.* at 354.

- g) a building site or construction or assembly project which exists for more than twelve months.
 - 3. The term "permanent establishment" shall not be deemed to include:
 - a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to an enterprise;
 - b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
 - c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
 - e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.
 - 4. A person acting in a Contracting State on behalf of an enterprise of the other Contracting State—other than an agent of an independent status to whom paragraph 5 applies—shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.
 - 5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.
 - 6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute for either company a permanent establishment of the other.⁷¹

⁷¹*Id.* at 43.

This draft provision specifically covers some of the areas which have recently caused many problems. For example, subparagraph 3(e) specifies that the operation of a so-called "propaganda office" in one of the contracting countries shall not constitute, by itself, a permanent establishment. The propaganda office is a comparatively recent device, used particularly by large American companies, which involves establishing an office in a foreign country to handle advertising, buying, marketing or scientific research, or related activities. Usually the corporation operates its selling and manufacturing activities through a subsidiary, but the "propaganda office" is a direct arm of the parent. This draft opens the door for more extensive activities, such as the sale of research results, by using the phrase "or for similar activities which have a preparatory or auxiliary character for the enterprise."⁷² This language is also intended to exclude from the definition an office established to service a patent or "know how" agreement.⁷³ It is not, however, intended to exclude an office established principally for the sale of research results.⁷⁴

Article 5 also excludes from the area of permanent establishment an independent agent or one who does not have authority to conclude contracts in the name of the employer other than contracts for the purchase of goods. This has been the general rule under United States treaties, but it has been difficult to apply.⁷⁵ The biggest problem arises in interpreting what is "authority to conclude contracts." This can mean anything from allowing formal approval to defeat the tax jurisdiction to considering a situation of co-approval as sufficient to constitute a permanent establishment.

The open draft also adopts the principles contained in most United States treaties concerning parent and subsidiary corporations. It applies to situations in which one corporation does not directly have a permanent establishment in a country. A corporation will not be considered a permanent establishment of a company for a given country on the sole ground that the second company controls the first.⁷⁶ Whether the parent has a permanent establishment due to the subsidiary's activities must be established by the ordinary rules. Only if such a case exists is the latter taxable in the other country.⁷⁷

⁷²*Id.*

⁷³O.E.C.D. *Report*, *supra* note 16, at 74.

⁷⁴*Id.*

⁷⁵See, e.g., *Commissioner v. Consolidated Premium Iron Ores, Ltd.*, 265 F.2d 320, 324-26 (6th Cir. 1959).

⁷⁶A. VAN DEN TEMPEL, *supra* note 9, at 39.

⁷⁷*Id.*

C. Classes of Income

Tax treaties operate by either wholly or partially exempting certain classes of income from the taxing authority of one of the parties to the treaty. With minor exceptions, income subject to treaty relief can be grouped into three classes: (1) Business income, (2) investment income, and (3) earned income which derives from present or past personal services.

The concept of the permanent establishment is especially critical in properly allocating business income. Presently, if a treaty country is engaged in business in the United States through a permanent establishment, it is normally taxable as a domestic corporation on its United States income. Therefore, most treaties provide that, once an enterprise operates through a permanent establishment in the United States, all United States source income is taxable even if not attributable to the permanent establishment.⁷⁸ The O.E.C.D. draft convention, however, provides that if an enterprise conducts business through a permanent establishment, only that portion of the profits attributable to the permanent establishment may be taxed by the country in which the permanent establishment is located.⁷⁹ This revised definition has the advantage of discouraging the establishment of a separate entity to carry on the activities constituting a permanent establishment solely to enable other forms of income to enjoy the benefits of the convention.⁸⁰

The O.E.C.D. draft also presents a broad-based definition of income constituting business income: "Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."⁸¹ In effect, the definition rules provide that anything called income, which is not otherwise accounted for in the convention, shall be considered business income.

In addition, the O.E.C.D. draft includes a common provision that once an enterprise operates through a permanent establishment in the country, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise dealing at arm's length with the enterprise of which it is a part.⁸²

Finally, the O.E.C.D. treaty solves one of the most inequitable provisions of many tax treaties. By not containing any general

⁷⁸Kragen, *Double Income Taxation Treaties: The O.E.C.D. Draft*, 52 CAL. L. REV. 306, 318 (1964).

⁷⁹O.E.C.D. Report, *supra* note 16, at 45.

⁸⁰See generally Surrey, *The United States Tax System and International Tax Relationships*, 43 TAXES 6 (1965).

⁸¹O.E.C.D. Report, *supra* note 16, at 45.

⁸²See Kragen, *supra* note 78, at 319.

source of income rules, it is possible that a contracting state may attribute industrial and commercial profits from activities carried on from outside the other contracting state to the permanent establishment.⁸³ The O.E.C.D. draft provides: "[I]f the enterprise carries on business (in another Contracting State through a permanent establishment), the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."⁸⁴

One particularly difficult area of business income which is considered separately in the O.E.C.D. draft is income derived from transportation, generally from the operation of ships and aircraft. Article 8 of the draft provides for taxing profits by the country in which the "place of effective management" is located.⁸⁵ In the past, the use of such terms as "homeport," "state in which the enterprise is situated," or "state of registry" has failed to settle the matter effectively, and litigation has ensued.⁸⁶ The employment of a new term, "place of effective management," may eliminate any uncertainty or lack of precision if a clear definition crystalizes quickly. It is also possible, on the other hand, that a whole host of new problems may arise from the adoption of new terminology.⁸⁷ The treaty provisions dealing with investment income, as a general rule, alleviate double taxation. They generally provide for reciprocal exemption from or reduction of source country taxation.

Some countries tax company profits at different rates, one rate if profits are distributed and another if profits are held by the company. This has been one of the contributing factors in creating difficulties for those who seek a uniform solution in the field of tax treatment of international dividend payments.⁸⁸ Another part of the problem is that the internal laws of some countries tax dividends from resident companies at the source, while nonresidents are not taxed at all.⁸⁹ Article 10 of the O.E.C.D. draft, and now of the Model Convention too, is an attempt to recognize and meet these difficulties.

The O.E.C.D. draft substantially adopts the principle found in most United States conventions—that the payee's country of

⁸³See, e.g., *Convention for the Avoidance of Double Taxation*, Apr. 16, 1947, United States-United Kingdom, art. III, 60 Stat. 1377 (indexed at 64 Stat. B1138), T.I.A.S. No. 1546.

⁸⁴O.E.C.D. *Report*, *supra* note 16, at 45.

⁸⁵*Id.* at 46.

⁸⁶Kraken, *supra* note 68, at 321.

⁸⁷*Id.*

⁸⁸*Id.* at 322-23.

⁸⁹See A. VAN DEN TEMPEL, *supra* note 9, at 34-37.

residence has the right to tax his dividend income received from sources in the other contracting country,⁹⁰ with the source country having a limited right to tax reserved.⁹¹ The limits are basically two-fold. Generally, the allowable tax is limited to fifteen percent of the gross amount of the dividends.⁹² A special provision is inserted, though, to benefit parent corporations receiving dividends from foreign subsidiaries. The foreign country is limited to a five percent tax on dividends paid by a subsidiary if the recipient is a company which holds at least twenty-five percent of the capital of the corporation paying dividends.⁹³

The same basic principle invoked for dividends is implemented in the tax treatment of interest income.⁹⁴ Interest income is generally taxable in the state of residence of the recipient. Debtor countries are generally reluctant to grant a complete exemption. In this regard, the O.E.C.D. draft provides for a ten percent maximum tax rate at the source country.⁹⁵ As a practical matter, the tax is borne by the borrower since lending institutions generally require that the borrower shall bear any taxes imposed by the source country with respect to interest payments.⁹⁶

⁹⁰O.E.C.D. *Report*, *supra* note 16, at 47-48. See also, B. BITTKER & L. EBB, *supra* note 61, at 183, 448.

⁹¹See, e.g., *Italy*, *supra* note 55, at art. VII.

⁹²O.E.C.D. *Report*, *supra* note 16, at 47-48.

⁹³*Id.* This type of provision, however, opens the door to much possible tax abuse. The O.E.C.D. draft commentary suggests that when negotiating specific conventions, states should have the opportunity to provide methods of preventing misuse of the convention to avoid taxes on dividends. *Id.* at 106.

⁹⁴*Id.* at 48. The 1972 Revised Text of Certain Articles of the Draft Double Taxation Convention contains certain modifications of the 1963 article on interest, such as recognizing the right of the state of the recipient's residence to tax, provided that the resident is the "beneficial owner" of the interest; while also permitting the State where the interest arises to levy a tax up to 10% of the interest amount. The revision provides that the reduced rate is not to be enjoyed by a resident of the State who carries on a trade or business through a permanent establishment in the taxing state. The commentary points out that since the creditor resident in the other contracting state is taxable both at the source of interest and at his residence, the double liability often hampers the movement of international investments and capital. The O.E.C.D. Committee on Fiscal Affairs concluded that interest should be taxed in the state of residence of the creditor, but left the right to impose a tax with the State of source. Carroll, *supra* note 43, at A-21. The same was confirmed in the 1977 *Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital*, art. 11.

⁹⁵O.E.C.D. *Report*, *supra* note 16, at 48.

⁹⁶A. VAN DEN TEMPEL, *supra* note 9, at 37. To lessen obstacles to international trade, the 1972 revision has suggested that parties to a treaty might wish to add a clause limiting taxation to the State of residence of a recipient where: (1) Interest is paid in relation to the sale on credit of any scientific, industrial or commercial equipment, or (2) interest is paid in relation to the sale on credit of any merchandise by one

The question involved with royalties is whether they should be treated as business income or investment income. If treated as business income, royalties would be primarily taxed at their source.⁹⁷ If treated as investment income, they would be primarily taxed in the country of residence of the recipient.⁹⁸ Thus, the definition of royalties is crucial. Many recent agreements have contained no definition of royalty, and the result has been a variation in the interpretation of the term. This has naturally led to some unhappiness among those involved, especially with today's greater use of agreements to furnish "know-how." The draft convention includes in its definition of royalty payment any "information concerning industrial, commercial or scientific experience."⁹⁹ It leaves no room for doubt that "know-how" payments are royalties and are to be treated as such.¹⁰⁰

Rentals of real property and royalties from natural resources are being exclusively treated as within the domain of the country in which the property is situated.¹⁰¹ The O.E.C.D. draft includes "immovable property" in this category, and extends the term to include livestock and farming equipment.¹⁰² The draft is very general in speaking of capital gains, basically taxing immovable property in the source state, and other property in the resident country.¹⁰³

The problem involved with the first two areas of income, namely that of distinguishing one type from the other, is not nearly as prevalent in the last area of concern—earned income. All treaties grant special exemption to foreign residents who are temporarily present in a treaty country with respect to income derived from personal services. The general rule that income from personal services is taxed at the source¹⁰⁴ remains in the O.E.C.D. draft.

The exceptions to this rule, however, are significant. Most treaties grant an exemption to a foreign resident provided he was

enterprise to another, or (3) interest is paid on a loan of any kind granted by a bank. Carroll, *supra* note 43, at A-22.

⁹⁷O.E.C.D. *Report*, *supra* note 16, at 49. See also *id.* at 116-21.

⁹⁸*Id.*, at 49.

⁹⁹*Id.* The O.E.C.D. Commentary of 1972 cites definition of "know-how" as "all the undivulged technical information, whether capable of being patented or not, that is necessary for the industrial reproduction of a product or process directly and under the same conditions," thus including experience and applicable to more than mere examination of the product or mere knowledge of the technique. Carroll, *supra* note 43, at A-22.

¹⁰⁰See generally Kragen, *supra* note 78, at 325.

¹⁰¹O.E.C.D. *Report*, *supra* note 16, at 45.

¹⁰²*Id.*

¹⁰³*Id.* at 49. See also Kragen, *supra* note 78, at 326-27, for a more comprehensive analysis. The general attitude toward capital gains is very difficult to pinpoint due to the wide variety of methods of imposing tax.

¹⁰⁴O.E.C.D. *Report*, *supra* note 16, at 50.

present in the country for only a limited period (usually 180 to 183 days) and that his compensation did not exceed a given amount (usually \$10,000).¹⁰⁵ Most treaties extend this exemption only if the compensation was paid by a nonresident alien or foreign corporate employer.¹⁰⁶ Several treaties additionally exempt compensation regardless of the type of employer, provided that the foreign resident spent less than ninety days in the country and earned less than \$3,000. In any case, the treaties do not employ permanent establishment as any sort of determinative in this regard.¹⁰⁷

The O.E.C.D. draft makes a distinction between independent and dependent personal services. Independent services are generally professional services such as those rendered by scientists, artists, writers, and teachers as well as those of physicians, lawyers, engineers, architects, dentists, and accountants.¹⁰⁸ Dependent services are those based on salaries, wages, and other similar compensation.¹⁰⁹ The income derived from the former is taxed in the country of residence unless the taxpayer "has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities."¹¹⁰ In such a case, the source state may tax him to the extent attributable to that base.¹¹¹ Dependent services are not taxable to the source state if: (1) The employee satisfies the 183-day rule, (2) the employer is not a resident of the source state, and (3) the salary is not paid by a permanent establishment in the source state.¹¹² Thus, the O.E.C.D. draft disregards the amount of compensation as a factor and eliminates the three-month rule. It does, however, incorporate a distinction between types of personal service income and extend the taxing authority of the source state to all employees of a permanent establishment.¹¹³

¹⁰⁵See, e.g., *Convention for Avoidance of Double Taxation and Prevention of Fiscal Evasion*, Oct. 28, 1948, United States-Belgium, art. XI, 4 U.S.T. 1647, T.I.A.S. No. 2833, as modified and supplemented Aug. 7 & Sept. 8, 9, 1957, 4 U.S.T. 1672, T.I.A.S. No. 2833, as supplemented Aug. 22, 1957, 10 U.S.T. 1358, T.I.A.S. No. 4280.

¹⁰⁶See, e.g., 4 U.S.T. at 1659.

¹⁰⁷*Id.*

¹⁰⁸O.E.C.D. *Report*, *supra* note 16, at 50-51. See also O.E.C.D. MODEL TREATY, *supra* note 21, at 34-35.

¹⁰⁹*Id.*

¹¹⁰*Id.*

¹¹¹*Id.*

¹¹²*Id.*

¹¹³See generally O.E.C.D. *Report*, *supra* note 16, at 51-52. See also O.E.C.D. MODEL TREATY, *supra* note 21, at 36-37. In addition to these provisions, most tax treaties as well as the O.E.C.D. Convention adopt special rules for directors' fees, entertainers, government employees, and students. They are disregarded here because of their limited significance to a broad analysis of the problem of double taxation.

D. Summary

The work of the O.E.C.D. has caused a great deal of change in the approach to the problem of double taxation. Although the draft was subject to many reservations, it has, for the first time, compiled the various positions of all the member countries and has developed a common ground from which to work. The effects of the draft, even disregarding the vast improvement in equitable allocation of taxing authority, can be very significant. The use of common concepts will enable taxpayers to determine their position in a broad variety of cases without having to study special provisions inherent in independently negotiated bilateral treaties. In addition, decisions in one state will, for the first time, be applicable authority to another state because of this common basis. This is not to say the draft is, or will be, a panacea. But the 1963 O.E.C.D. draft and the continuing work of the Fiscal Committee, now Committee on Fiscal Affairs, including most importantly the 1977 Model Convention, do strike an important chord in harmonizing international fiscal relationships.

IV. THE PROBLEM OF FISCAL EVASION

Unlike the problem of double taxation, the problem of international fiscal evasion has not received widespread concern or public support for the attempts at a solution. In fact, often the states involved do not wish to concern themselves with the problem. The provisions concerning fiscal evasion warranted no more than brief notice in the 1963 O.E.C.D. draft.¹¹⁴ However, the 1977 O.E.C.D. Model Convention is worded much more clearly and is more extensive on this subject so as to avoid such problems. Outside of their general support for an attempted solution of the tax evasion problem, the Internal Revenue Service and the Department of the Treasury are limited in the kind of help they can provide.¹¹⁵

Because of this general apathy, not as much work has been put forth to solve this problem of fiscal evasion as has been to solve the problem of double taxation. Thus, this portion of the Article will first discuss the original principles set forth by the League of Nations, and then analyze some of the present problems involved in reaching a solution in this significant area of taxation—international enforcement of tax claims.

A. Work of the League of Nations

In analyzing the problem, the League developed a set of broad principles as to basic problems involved with international fiscal

¹¹⁴O.E.C.D. *Report*, *supra* note 16, at 26.

¹¹⁵See Eichel, *supra* note 5, at 25.

evasion.¹¹⁶ It was hoped that setting forth original guidelines would help the member countries implement provisions that would solve the problem. Aside from the considerations inherent in both double taxation and fiscal evasion,¹¹⁷ the League noted a number of other factors.¹¹⁸

The League initially concluded that measures for meeting the problem of fiscal evasion would provide an important link toward an international tax morality among taxpayers. The League's appeal to taxpayers declared:

[T]hese measures are in the interest of all honest taxpayers. At the present time, there is a great deal of concealment of income and there are taxable persons who pay no taxes at all. If the tax on all income could be brought into the treasuries of the various States concerned, those States would find, as compared with the present position, a very important additional yield, which might . . . enable them . . . to reduce the rates of their taxes.¹¹⁹

Thus, the League stressed an international tax morality among taxpayers which would enhance normal economic relations and at the same time reduce the burden on the honest taxpayer. Given the need and desirability of such an improved tax morality, the League was clear as to how it might be encouraged:

It is indeed the duty of revenue authorities to see that each taxpayer should pay the taxes for which he has been assessed according to the laws of the country under the jurisdiction of which he comes. Failure to collect such taxes is indeed susceptible of impairing the services which the Government should render to the public or bringing about an increase of the taxes borne by non-delinquent taxpayers.¹²⁰

A second problem caused by tax evasion was interference with the free circulation of capital. The Financial Committee, in response to the Experts 1925 Resolutions, reported to the Council of the League that any future investigation of the problems of fiscal evasion would have to consider "the disadvantage of placing any obstacles in the way of the international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction."¹²¹

¹¹⁶*L.N. 1925*, *supra* note 10, at 22-28.

¹¹⁷See Carroll, *supra* note 13, at 696-97.

¹¹⁸*Id.*

¹¹⁹*L.N. 1925*, *supra* note 10, at 28.

¹²⁰*L.N. 1946*, *supra* note 32, at 45-46.

¹²¹*L.N. 1927*, *supra* note 11, at 5.

In the process of its investigation, the League had to determine whether the model conventions should be multilateral or bilateral in form. Notwithstanding the League's previous conclusions as to the necessity of an agreement by as many nations as possible, the League was forced to use the bilateral approach. Such a course was dictated by the diversity of the fiscal systems represented. The use of a collective or multilateral approach would preclude the need for delicate negotiations between the governments due to fundamental differences in their systems. The need to consider diverse public opinions in the various countries in order to engender taxpayer confidence and support further convinced the League to follow the bilateral route.¹²²

The Committee, therefore, reasoned that it would establish standards which would both allow for the necessary bilateral negotiations and introduce a certain measure of uniformity in international fiscal law. Thus, forced to work at a higher level of abstraction than desired, the League requested the various nations to subscribe to basic standards and commit themselves to general patterns of assistance.¹²³ Unfortunately, some nations believed this was the League's sole request. But the League asked for much more, including the promulgation of regulations and more specific provisions suited to each country's peculiar tax system pursuant to any bilateral negotiations:

[I]t will be necessary to draw up regulations for the application of the Convention. In the Committee's opinion, it would be best that these rules should not be laid down in the Conventions themselves. They are of too special a nature, and, moreover, the fact that they were embodied in a convention might delay the introduction of changes which circumstances or experience had shown to be necessary. Accordingly, the Committee proposes that the highest fiscal authorities should be left free to agree upon the practical measures necessary to implement the Convention.¹²⁴

One of the more pervasive considerations with which the League chose to deal was the notion of protecting national sovereignty.¹²⁵ This idea reduced itself into three principles. The first was that tax claims from another government would not be privileged debts. The purpose was, of course, to protect the rights of both general and governmental creditors by preserving their positions against the

¹²²See *id.* at 8-9.

¹²³*Id.* at 8.

¹²⁴*Id.* at 26.

¹²⁵L.N. 1925, *supra* note 10, at 27.

taxpayer relative to the foreign tax claim. The second was that the foreign claim had to be res judicata. This was meant to prevent the courts of one nation from interpreting or having to interpret the tax laws of another. The third principle was that the enforcing state could neither be made to use methods other than those which it had nor be forced to use methods not provided for under the laws of the applying state. Behind this was the notion that a nation's legal processes were to be free from employment of measures based on alien concepts, and that the specific means of carrying out the intended collection assistance would have to be dictated by each nation's own internal legislation.¹²⁶

There were three basic reasons for the requirement that all claims possess the final character of res judicata. The first was to preserve the sovereignty of both the applying state and the state to which application was made. The second was to avoid the possibility of a nation's courts being burdened with the expensive and time consuming task of interpreting another nation's tax laws. The third was that "it would hardly be desirable to invite a foreign administration to take measures to collect a debt which was still liable to be cancelled on appeal."¹²⁷

The question of whether two tax systems of two negotiating governments were compatible was of primary importance to the League in determining the feasibility of reciprocal assistance. As a way of testing compatibility, the League used what it stated to be a "rule based to some extent on the highest common factor, [i.e.,] that no means of execution should be employed unless it is included in the laws of both States concerned."¹²⁸ There were two principles stated as the basis for such a rule. The first was the requirement that the methods of execution be limited to those provided by the state to which application is made. The second was the principle that the state to which application is made cannot employ any methods which might offend the system of the applying state and need not use methods not provided by the applying state.¹²⁹

One might then have asked where this rather confining test left the two negotiating governments. The only method remaining seemed to be two types of methods, one which was to be found in both systems, and one found only in the state to which application was made so long as it was not offensive to the laws of the applying state. Due to the often subtle diversities of the various tax systems,

¹²⁶*Id.* at 27, 35.

¹²⁷*L.N. 1927, supra* note 11, at 28.

¹²⁸*Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion*, L.N. Doc. No. C. 562. M. 178., 32 (1928).

¹²⁹*Id.* at 30, 32.

the question of whether a method was "offensive" could turn into a major inquiry. This inquiry could turn on an examination of the basic concepts which underlie each country's collection procedure.

There is another concept of reciprocity at which the League only hinted: namely, when one country's collection process is far less efficient than the other's, can there really be reciprocity?¹³⁰ This is reciprocity in the sense of cooperation and is perhaps most important when negotiations are between a developed and an underdeveloped country.

Finally, the League's concern for public opinion went in two directions. In one way, it was forced to deal with public sentiment vis-a-vis initial agreement to accede to such collection provisions. In the other way, the League faced the necessity of having to write into the collection provisions certain exceptions in order to provide for diverse public policies. As to the need for accommodating public sentiment towards these collection provisions, the League stated:

As regards the carrying out of the recommendations . . . for countering tax evasion, the Experts desire to emphasize the fact that it will only be possible to carry out these recommendations in any given country if, in the first place, public opinion in that country is sufficiently prepared, and secondly, if the Government of the country considers that the measures advocated are not only compatible with public opinion, but also are required for collection of its own taxes.¹³¹

The result of the League's work was the manifestation of its principles into three contexts: The basic Resolutions of 1925; the Draft Model Bilateral Conventions of 1927-1928; and the final Draft Model Bilateral Conventions of 1940, 1943, and 1946 in Mexico City and London.¹³²

The following are the basic Resolutions of 1925 in which can be found most of the League's principles and upon which all later work of the League is based:

1. Each State shall recover within its territory, in accordance with its own law, taxes due in another State, including taxes due from persons not nationals of the latter State. The State to which such an application is made may not, however, be requested to apply any method of execution not provided for under the law of the State making the application.

¹³⁰*L.N. 1925, supra* note 10, at 26.

¹³¹*Id.* at 34.

¹³²Carroll, *supra* note 13, at 701, 707.

2. Taxes to be recovered shall not, in the State to which application is made, be regarded as privileged debts.

3. Prosecutions and other measures of execution shall be carried out, without *exequatur*, on the production of documents proving that the liability in question is *res judicata*. If the fiscal debt may still be the subject of an appeal, conservatory measures may be taken on the production of a decision executable against the debtor.¹³³

While the latter conventions' reappraisals did not introduce any significant new thoughts, they did redefine and reinforce the old principles. There were, however, a few points which were modified or expanded. The first was the substitution of "definitely due" for "*res judicata*," which may have caused more uncertainty than usefulness. The League had previously attached certainty to the term *res judicata* by limiting it to a claim which was no longer liable to be cancelled on appeal. In the 1946 convention, the Committee's Commentary to the Conventions remarked:

According to Article XIX of the Protocol in the Mexico Draft, XVI in the London Draft, the Convention does not apply to measures of conservancy in respect to taxes that have not yet been assessed. However, as regards taxes that have been *assessed, but are not definitely due*, the tax authorities concerned may request the corresponding authorities of the other State to take such measures of conservance as are authorized by the revenue laws of the State interested.¹³⁴

Whether this meant no change from the previous requirement, "beyond all possibility of appeal," is still questionable. There may be steps between a mere assessment and a claim no longer amenable to appeal, such as when only a lower court decision is rendered. To add to the uncertainty, the convention also speaks of claims which are "finally determined" as well as those which are "definitely due."¹³⁵ However, if one assumes that the League intended to maintain the same notion that it is undesirable to allow claims that are still outstanding to be cancelled on appeal, it would be difficult to conclude that it intended to allow anything less stable for collection than a claim possessing that degree of finality which had previously been required by the term *res judicata*.

The second point was the League's response to what it considered to be a rather cool reception to the collection provisions. The League had suspected during its early work why these provi-

¹³³L.N. 1925, *supra* note 10, at 35.

¹³⁴L.N. 1946, *supra* note 32, at 53 (emphasis added).

¹³⁵*Id.* at 52.

sions met with such distrust.¹³⁶ In essence, the various governments were fearful of placing their tax facilities at the disposal of foreign authorities and, thereby, being required "to introduce new tax practices in order to suit the requirements of foreign governments."¹³⁷ Also of concern to the governments was the possibility of prejudicially affecting the free circulation of capital. Of concern to taxpayers was the possibility of these provisions granting a foreign taxing authority greater or additional powers not allowed by its domestic legislation. To meet this lack of confidence in the provisions, the new Model Conventions contained several articles which stressed the reciprocal aspects and provided certain safeguards. Reciprocity was provided in the sense of compatibility as well as in the sense of cooperation. The League provided a rather bland test to discover whether reciprocal cooperation existed: "[R]eciprocity shall be deemed to exist when the request is accompanied by a declaration by the competent authorities who make the application, officially confirming that any similar request would be complied with in accordance with the laws of the applicant state."¹³⁸

Safeguards were directly provided for in the Article allowing certain excuses from compliance, such as when the request relates to a taxpayer who is a national of the state applied to or when compliance with the request compromises its security or sovereign rights.¹³⁹

The third distinguishing factor of the Mexico and London Conventions was the limiting provisions. The new collection provisions were limited to those items of income dealt with in the Conventions on double taxation. This made the collection provisions complementary to the double taxation provisions, thereby carrying even further their prior considerations of the correlation between the two. Further limitations were set out in the accompanying Protocol, which provided for a monetary limit below which no assistance would be given, and for a required statement by the interested state that the amount due was not recoverable in the applying state.¹⁴⁰

B. Present Problems of Tax Evasion Treaties

This discussion begins with the most telling, if not fundamental complaint: namely, the problem of having to connect two systems which do not share a common background. Most arguments against

¹³⁶See *id.* at 44-48.

¹³⁷*Id.* at 46.

¹³⁸*Id.* at 47.

¹³⁹*Id.* at 48.

¹⁴⁰*Id.* at 52.

collection provisions, if not initially founded on it, always seem to fall back on this incompatibility. Since this problem emerges in diverse contexts throughout the rest of this section, only a few of its more obvious aspects, stated in extremely general terms, are herein mentioned. Such provisions, say the critics, would "force upon the courts of the United States the duty of interpreting foreign tax statutes and will require a scrutiny of the relations between the foreign state and its citizens and force the courts to pass on questions of local policy."¹⁴¹ And what has turned out to be the most critical aspect of all is the risk that taxpayers might be unjustly prejudiced in the enforcement of such assistance provisions without adequate judicial safeguards.

It is next suggested that the United States treaty provisions dealing with collection assistance are not self-executing and, therefore, are in need of *enabling* legislation.¹⁴² Aside from the weight which might be given to the question of whether any revenue measures can be self-executing due to the restrictive language of article I, section 7 of the Constitution, the critics have concluded that the gap resulting from the language of the Internal Revenue Code has to be filled by Congress.¹⁴³ With the possible exception of the wording of the Internal Revenue Code, one might counter these contentions by stating that what in fact has caused all this uncertainty was not the lack of supposedly needed legislation, but rather silence on the part of the Treasury.

The opponents of collection provisions, in addition, have expressed doubts as to the constitutionality of what they deem to be needed implanting legislation.¹⁴⁴ Their reasoning is as follows: Article 1, section 8 of the Constitution provides that the Congress shall have the power "to levy and collect taxes, duties, imposts, and excises to pay the debts and provide for the common defense and general welfare of the United States." Therefore, "this authorization does not envisage the collection of taxes for a foreign government."¹⁴⁵ Furthermore, they reason: "It is equally clear that the purpose behind this Constitutional grant of authority has not been extended by the enactment of the Sixteenth Amendment so as to include the right to collect foreign taxes or otherwise enforce the revenue statutes of a foreign government."¹⁴⁶ However one feels about this argument, the

¹⁴¹ 1951 Hearings, *supra* note 31, at 23 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁴² *Id.* at 27-28.

¹⁴³ *Id.* at 29.

¹⁴⁴ *Id.* at 37-38, 73.

¹⁴⁵ *Id.* at 36.

¹⁴⁶ *Id.* at 30.

fact is that many extremely important questions remain unanswered.

The use of the terms "finally determined" and "definitely due" in reference to claims eligible for enforcement have raised many interpretative difficulties.¹⁴⁷ A threshold distinction must be made as to whether such claims are in the nature of a judgment or something less, such as an administrative assessment. As noted before,¹⁴⁸ the League of Nations was quite clear that the claim must be beyond all avenues of appeal and, therefore, a final judgment was required. However, this intent was later blurred by its abandonment of "res judicata" in favor of "finally determined" and "definitely due."¹⁴⁹ In the Swedish Treaty of 1939, the accompanying Protocol states that "finally determined" is to mean "claims which are no longer appealable, or which have been determined by decisions of a competent tribunal, which decision has become final."¹⁵⁰ The problem with this definition is whether "or" applies to "claims" or to "appealable." If it applies to the former, it implies that an administrative assessment is valid; if to the latter, it merely requires that all judicial and administrative remedies have been invoked and decided.

One commentator has concluded that the United States, having in mind the term "res judicata" to mean beyond all possibility of appeal, chose to use "finally determined" in order "to represent a difference not only in phraseology but also in substantive effect," intending this term to mean "only that it must be based upon an assessment by an administrative body."¹⁵¹ In light of the use of "finally determined" by the League of Nations and the reason suggested for such a change, this above conclusion is of doubtful validity.

No matter whether one chooses to take the administrative assessment route or the judgment route, there are further questions that must be answered. Within the realm of allowing an administrative assessment to form the basis of a claim for collection assistance, the most often heard complaint is that of allowing the case to be heard on the merits in a foreign court. It seems to always be assumed that a claim based on an administrative assessment can be tested on the merits, thus causing a foreign court to interpret complicated tax laws.¹⁵² It has been suggested that not allowing the taxpayer to contest the claim on the merits in a foreign court would

¹⁴⁷See Note, *International Enforcement of Tax Claims*, 50 COLUM. L. REV. 490, 496-98 (1950).

¹⁴⁸See text accompanying note 125 *supra*.

¹⁴⁹See text accompanying note 133 *supra*.

¹⁵⁰Convention with Sweden on Double Taxation, Mar. 23, 1939, United States-Sweden, art. XXII, para. 12, 54 Stat. 1759, T.S. No. 958.

¹⁵¹Note, *supra* note 147, at 498.

¹⁵²See Leflar, *supra* note 2, at 218.

violate the due process clause of the Constitution, and thereby relegate the claim to an administrative assessment, placing the claim in a better position than a judgment which must at a minimum comply with notions of competency, jurisdiction, and notice.¹⁵³

Furthermore, the question is raised as to whether one in a state which applies the Act of State Doctrine will be in a position to question the tax on the merits. However, there is considerable doubt as to whether this doctrine, limited in any event to a very few countries, will protect the revenue laws of a foreign state. As one source has stated:

In the language of the Sabbatino decision, it involves the "validity of the public acts a recognized foreign sovereign power commit(s) within its own territory." "Act of State" refers to "public acts" which have been completely "executed" within the foreign territory, as distinct from executory court judgments or penal or revenue laws whose enforcement is sought abroad.¹⁵⁴

In support of the validity of administrative assessments is quite simply the fact that they are easier to get than judgments. This is so because the United States tax jurisdiction reaches further than its adjudicatory jurisdiction. But countering this perhaps more desirable interpretation is the notion that the requirement of a judgment with its more limited reach has a constraining effect on a country's tax laws by saying the country can have all the country can get but the country can get only what its courts can reach. Therefore, those taxpayers who feel that the reach of the United States taxing jurisdiction is justified will be more susceptible to arguments in favor of the validity of administrative assessments; those opposed to the extent of the United States tax reach will tend to favor the more limiting requirements of a judgment.

If one concludes that judgment is to be the intended requirement, there exists a further range of possible interpretations. One possible approach would accord the foreign tax judgment the same status as that of a state or federal tax judgment. Although the foreign tax judgment could not be challenged on the merits, it would still be subject to a variety of defenses; i.e., lack of jurisdiction, lack of notice, or lack of competence.¹⁵⁵ But, inasmuch as assistance is often needed to reach those who are neither citizens nor domiciliaries of the applying state, the defense of lack of *in personam*

¹⁵³1951 Hearings, *supra* note 31, at 20-21 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁵⁴H. STEINER & D. VAGHTS, TRANSNATIONAL LEGAL PROBLEMS 588 (1968).

¹⁵⁵Note, *supra* note 147, at 497.

jurisdiction would work to greatly inhibit the use of these collection provisions. Again, one may not view this as being an overly burdensome limitation if he feels that a taxpayer who is neither domiciled in nor a citizen of the taxing state should not have been subject to its taxes in the first place. An alternative to the above interpretation would be to regard the judgment as one to be enforced on the basis of comity.¹⁵⁶

At the other end of the spectrum of possible interpretations from administrative assessment is the construction which gives the judgment extraordinary treatment by barring *all* defenses to the claim. Such a position, it is claimed, would be the only way to make the collection provisions "fully effective."¹⁵⁷ However, this interpretation is subject to doubt, for such a status has been challenged as "legally untenable, inasmuch as it might result in a violation of the due process clause of the Constitution,"¹⁵⁸ as well as being an impractical solution by according a foreign tax judgment a more favorable treatment than a state or federal tax judgment.

If and when the United States is asked to enforce a foreign tax claim, the question will arise as to whether it will look to the substance behind the claim or merely test it along the lines of procedural due process.¹⁵⁹

¹⁵⁶See Eichel, *supra* note 5, at 67.

¹⁵⁷1951 Hearings, *supra* note 31, at 21 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁵⁸*Id.*

¹⁵⁹The following examples show areas where the United States might want to test a foreign claim on its merits.

The first claim to consider is that based on a discriminatory tax. There might be two answers to this. The first is the public policy exception found in all existing American general collection assistance agreements. The second answer is not to enter into such assistance agreements with a state having a "discriminatory" tax system. If one were to examine the legislative history of tax conventions, one would readily see that a thorough scrutiny is made of the other country's tax system before an agreement is signed. See, e.g., JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS (1962). If, at some later date, a country were to engage in discriminatory practices, the United States could, if it chose to do so, resort to the "public policy" exception and refuse to grant enforcement to the tax claim. See Note, *supra* note 147, at 499. This defense of a discriminatory tax system is of course more potent when made by a United States citizen faced with a tax bill owed to another country but is enforced by the United States.

A second consideration is whether, while enforcing a judgment or assessment against a citizen of a third state, the United States will look behind the judgment or assessment to see if the tax treatment applied to him is the same as that applied to American citizens. That is to say, if France were to discriminate against Englishmen, would the United States still enforce a claim against the Englishman for France? Fortunately, a provision similar to that in the Swedish Treaty will remedy such a situation. *United States Treaties and Other International Agreements*, Mar. 23, 1939, 15

There are several problems in attempting to discern an intended method of collection because of the uncertainty generated by the wording of these collection provisions. Additional problems concern the possible unavailability of the Internal Revenue Code provisions and the inability—or unwillingness—of the United States revenue authorities to say exactly what procedures they intend to follow. The problem here is not concerned with the methods to be used in the other country, which is extremely uncertain in itself, but rather what methods the United States must use. The methods to be used will be determined only if the nature of the claim transmitted can be adequately defined. The range of possible definitions can run from looking upon these claims as strictly American,¹⁶⁰ to invoking what the League of Nations suggested, or to using methods common to *both* systems.¹⁶¹ The task of determining how these claims were intended to be viewed is certainly a hopeless one for the variations among the treaties point in all directions.

The limitation along lines of nationality, which prevented the operation of collection provisions against citizens, corporations, or other entities of the state to which application was made, was in response to a series of objections directed toward the unrestricted application of these collection provisions. The most fundamental objection indicated the reluctance on the part of Americans to subject themselves to taxation abroad if they felt the United States was bound to place a lien or restraint on their property at the request of a foreign government asserting the claim.¹⁶² Another closely related objection concerned the possibility of an American operating abroad being subject to the added risk of levies which he justifiably felt were arbitrary or were inconsistent with the principles of American law. The result was that the United States, committed to collection assistance, would be in the embarrassing position of having to render help against its own citizen on what might be a completely unjustified claim.¹⁶³ A further objection stated that the relationship between citizens and the federal government did not contemplate the federal government using citizens' contributions to enforce foreign tax claims against them. Such an objection was certainly reminiscent of a problem the League of Nations had experienced

U.S.T. 1824, T.I.A.S. No. 5656, *modified and supplemented* Oct. 22, 1963. However, this limitation stops far short of the scope within which the negotiators have expressed they would like to work.

¹⁶⁰See, 1951 Hearings, *supra* note 31, at 17 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁶¹L.N. 1925, *supra* note 10, at 34-35.

¹⁶²1951 Hearings, *supra* note 31, at 16-17.

¹⁶³*Id.*

concerning the possible distrust that might infect a domestic system if part of the internal machinery had to respond to foreign claims against its own citizens.¹⁶⁴ Therefore, operation of these provisions by the United States against its own citizens would put Americans operating abroad at a disadvantage, inasmuch as it would remove the limited liability protection against tax claims enjoyed by most aliens.¹⁶⁵

Many questions of the interpretation and allocation of tax burdens placed on American business abroad had been negotiated for years with competent tax authorities of the foreign country without any assistance from Washington. Thus, the added leverage given a foreign tax administration by these collection provisions was met with understandable concern by taxpayers. Because of this added leverage, it was also assumed, due to the growing influx of American business abroad, that these provisions were of greater interest to foreign governments than to the United States, and that Americans should therefore not be willing to so readily accede to such provisions.

An interesting objection stated that the American policy of political sanctuary, long afforded aliens, should be extended to their property as well, for without such an extension, the United States might find itself in the position of allowing political asylum to an alien while simultaneously attacking his property on behalf of the country from which safety was sought.¹⁶⁶ The objection goes further to include the possibility that collection provisions might prevent a taxpayer from placing property in the United States for safekeeping, looking toward the day he might have to seek refuge from adverse political developments at home.

A broader concern, perhaps including much of the above, is possible interference with the free flow of capital caused by collection provisions. Contrary to the broad purpose of tax treaties to eliminate trade barriers, these collection provisions could cause unnatural shifts in capital as well as delay the more important promulgation of substantive provisions on double taxation.¹⁶⁷

Finally, the most pervasive of all taxpayer concerns is the possibility of having to defend against a United States tax claim being executed by a foreign procedure which does not meet the American concept of due process. As this notion has permeated so much of the discussion of other problem areas, it is noted here only to emphasize the fear generated by taxpayer uncertainty when

¹⁶⁴L.N. 1925, *supra* note 10, at 26.

¹⁶⁵1951 Hearings, *supra* note 31, at 41.

¹⁶⁶*Id.* at 39-40.

¹⁶⁷L.N. 1946, *supra* note 32, at 46.

these agreements are entered into with countries whose notions of notice, jurisdiction, and competence differ from the American notions. Much of this fear has often been encouraged by the possibility of a taxpayer having to face an overzealous tax collection machine which operates outside of the foreign country's judicial process. It has been sought to counter these doubts by again indicating the need for a certain latitude of discretion to rest in those who would administer these provisions. But assurances by the authorities that requests for assistance will only be made in rare cases and with due consideration for maintaining the taxpayers rights have failed to allay these apprehensions.¹⁶⁸

C. The 1977 Model Convention

The purpose of the 1977 Model Convention is not to question the principles and general structure of the 1963 Draft Convention,¹⁶⁹ but rather to scrutinize all the questions of a legal, theoretical, or practical nature which have arisen in the intervening years.¹⁷⁰ In drafting the 1977 Model Convention, it has been possible in several instances to broaden or alter the texts of certain articles.¹⁷¹ Consequently, this work has produced a much clearer and more specific text and official commentary.

Nevertheless, the O.E.C.D. Committee on Fiscal Affairs considers that, in regard to its work in the 1977 Model Convention, the most important results are those reflected in the Commentaries on the Articles.¹⁷² These commentaries have definitely, in every way, clarified many of the issues or doubtful points created by the 1963 draft.

Briefly stated, the following are some of the most noteworthy improvements brought about in the 1977 Model Convention. Article

¹⁶⁸See 1951 Hearings, *supra* note 31, at 58-61. The 1972 O.E.C.D. revision, under the Commentary of Article 25, provided for a mutual agreement procedure, whereby a United States corporation may apply to a competent Treasury Department authority to appeal a mere risk of incorrect taxation, but not in accordance with the convention of a particular country. In the procedure, states can authorize competent authorities to settle questions of double taxation who can call on the O.E.C.D. Fiscal Commission for guidelines. Carroll, *supra* note 43, at A-22-23.

¹⁶⁹See O.E.C.D. MODEL TREATY, *supra* note 21.

¹⁷⁰*Id.*

¹⁷¹See, i.e., art. 5 (Permanent Establishment), paras. 3 & 4; art. 9 (Associated Enterprises), para. 2; art. 17 (Artists and Athletes), para. 2; art. 19 (Government Service); art. 21 (Other Income), para. 2; art. 24 (Non-Discrimination), para. 5; art. 25 (Mutual Agreement Procedure), paras. 1 & 2.

¹⁷²*Id.*, see, i.e., the commentaries on arts. 5 (Permanent Establishment), 10 (Dividends), 19 (Government Service), 24 (Non-Discrimination), 25 (Mutual Agreement Procedure), 26 (Exchange of Information).

7, paragraph 1 aims at the establishment of a fair tax regulatory system for the revenue obtained through a permanent establishment. Article 7, paragraph 1, parallels Article 9 on associated enterprises and employs the well known "arm's length clause." Under such a clause, only profits attributable to the permanent establishment can be taxed by the country or countries where that establishment is located. Article 9 (Associated Enterprises), 11 (Interests) and 12 (Royalties) seek to avoid excessive tax payments and make it possible for the parties to readjust the target base to which the taxes are applied. Article 9 also touches upon the adjustment of taxes by the other contracting state and makes a modest attempt to avoid excessive double-taxation by recommending a readjustment in both directions.¹⁷³

Turning from the subject of tax avoidance, Article 26 (Exchange of Information) deals with tax evasion. Although the 1963 Draft Convention contained an abbreviated form of Article 26, the 1977 Model has expanded quite significantly upon the material, introducing, *inter alia*, the new concepts of *automatic* and *spontaneous* exchange of information.¹⁷⁴

V. CONCLUSION

Although most recent tax treaties include clauses aimed at avoiding cases of economic double taxation, specifically those which follow the Model Treaty, problems involved in establishing a framework for agreement and dependability are a very complex task. Beyond even the traditional problem of general apathy on the part of the governments and taxpayers, there are still serious difficulties in reaching a common ground of agreement. In the past, efforts at a model convention have either put forth such a strict model that no one could agree to any substantial provisions while attempting to implement the model, or have adopted the overly broad principles established by the League which, while being accurate in what they portray, do not establish any tangible tools with which two countries can negotiate.

Now that we have a more sophisticated and precise model convention which, rather than laying down a strict path to follow, sets out some methods of approach to the problem, the O.E.C.D. and other international organizations ought to continue their efforts to

¹⁷³Van Hoorn, *Problems, Possibilities, and Limitations with Respect to Measures against International Tax Avoidance and Evasion*, 8 GA. J. INT'L & COMP. L. at 768 (1978).

¹⁷⁴O.E.C.D. MODEL TREATY, *supra* note 21, at Commentary, art. 26, No. 9 (b) & (c), 186.

create more definite methods of implementation.¹⁷⁵ These methods will not necessarily result in a multilateral harmonization of international tax enforcement procedures, but they will at least enable countries to reach some workable agreement. Judging from the past dearth of agreement in this area, such a result would be a significant step forward.

¹⁷⁵Among other activities in this respect, the United Nations Group of Experts on Tax Treaties between Developed and Developing Countries (U.N. Group of Experts) has held seven meetings between 1968 and 1977. To date, seven reports have been published by the United Nations under the title, *Tax Treaties Between Developed and Developing Countries*. Each report is divided into two parts, one being a summary of the proceedings, the other including a suggestion and consideration prepared by the Secretary General on behalf of the Expert Group. The reports bear, respectively, the following document numbers: U.N. Doc. E/4614-ST/EC/110 (1969); U.N. Doc. E/4936-ST/EAC/137 (1970); U.N. Doc. ST/EAC/166 (1972); U.N. Doc. ST/ECA/188 (1973); U.N. Doc. ST/ECA/18 (1975); U.N. Doc. ST/ESA/42 (1976); U.N. Doc. ST/ESA/78 (1978).

Notes

The Effect of the Indiana Divorce Law upon the Application of Section 17a(7) of the Bankruptcy Act

I. PHILOSOPHICAL HISTORY

Generally, two theories have provided the theme for the evolution of American bankruptcy law in the twentieth century. The first concept was that there should be an equal distribution of the assets of the insolvent debtor among his general creditors.¹ Historically, this consideration gave strong impetus to the enactment of bankruptcy legislation. Commerce needed to be protected from the dishonest debtor who was about to secrete or was secreting his assets for the purpose of hindering, defrauding, or delaying his creditors.²

In response to the need for legal control over the person who had removed, or was about to remove, himself or his property from the reach of the law, early bankruptcy legislation was initially directed toward criminal conduct.³ Born in continental Europe and England during the middle ages, bankruptcy law grew as a weapon against the commercial trader who fled from the commercial center or who concealed his property to prevent his creditors from exercising legal remedies.⁴ Relief was strictly creditor-oriented. Proceedings were involuntary in that they could only be instituted by an aggrieved creditor.⁵ A remedy did not exist that could be exercised by the debtor in his own behalf. In addition, the then existing involuntary creditor proceedings provided only for the liquidation of assets and distribution of the proceeds; there was no provision for

¹See *In re Harwald Co.*, 497 F.2d 443 (7th Cir. 1974). See generally Loiseaux, *Domestic Obligations in Bankruptcy*, 41 N.C. L. REV. 27 (1962).

²See *In re Time Sales Fin. Corp.*, 474 F.2d 1197 (3d Cir. 1971). In discussing the purposes of the Bankruptcy Act the court said: "One of the chief purposes of the bankruptcy laws is 'to secure a prompt and effectual administration and settlement of estates of all bankrupts'" *Id.* at 1201 (quoting *Katchen v. Landy*, 382 U.S. 323, 328 (1966) (quoting *Ex Parte Christy*, 44 U.S. (3 How.) 292, 312 (1845))).

³COMMISSION ON BANKRUPTCY LAWS OF THE UNITED STATES, REPORT OF THE COMMISSION ON BANKRUPTCY LAWS 77 (CCH 1973). [hereinafter cited as COMMISSION ON BANKRUPTCY LAWS]. The commission was created by Congress in 1970 to study, analyze, evaluate, and recommend changes to the Bankruptcy Act to meet adequately the needs of present day technical, financial, and commercial activities. Pub. L. No. 91-354, 84 Stat. 468 (1970).

⁴Trieman, *Escaping the Creditor in the Middle Ages*, 43 LAW Q. REV. 230 (1927).

⁵COMMISSION ON BANKRUPTCY LAWS, *supra* note 3, at 77.

the discharge of the obligations left unsatisfied after distribution of the debtor's assets.⁶

As time passed, however, a second concept developed an increasing importance: an honest debtor should be given a fresh start in the community.⁷ Relief should be afforded to the debtor as well as to his creditors. The cooperative action roots of modern bankruptcy law date back to the English common law which provided for contracts of composition⁸ and assignments for the benefit of creditors. Those insolvency laws were premised on the need of an unfortunate debtor to meet his obligations by equitably apportioning his assets among his creditors. Unlike the earlier creditor-protection statutes, these laws provided for voluntary filing by the debtor.⁹ In addition, relief included a discharge among the available remedies as well as liquidation of assets and distribution of the proceeds to creditors.¹⁰

This concept of rehabilitation did not evolve solely for the benefit of the debtor, but also for the benefit of the economic community as a whole. An individual who is required to live under an impossible debt load becomes a burden on society, tends to be less productive, and is removed from the marketplace as a viable purchaser of goods and services. Rehabilitation of the debtor makes sound economic and social sense.¹¹

It is also important to note the change in the nature of the debtor applying for bankruptcy relief. Prior to World War II, bankruptcy was primarily a businessman's remedy; however, the evolution, growth, and maturation of the consumer credit economy has turned bankruptcy from the almost exclusive province of the entrepreneur into the haven of the wage earner.¹² Indeed, the number of bankruptcies in the United States has increased dramatically since 1950.¹³ The growth has been mainly in the number of consumer bankruptcies which grew from 8,566 in 1946 to a peak of 191,729 in 1967 as

⁶*Id.*

⁷See *In re Nickerson & Nickerson, Inc.*, 530 F.2d 811 (8th Cir. 1976); *Fallick v. Kehr*, 369 F.2d 899 (2d Cir. 1966).

⁸A contract of composition is defined as:

An agreement, made upon a sufficient consideration, between an insolvent or embarrassed debtor and his creditors, whereby the latter, for the sake of immediate or sooner payment, agree to accept a dividend less than the whole amount of their claims, to be distributed *pro rata*, in discharge and satisfaction of the whole.

BLACK'S LAW DICTIONARY 357-58 (rev. 4th ed. 1968).

⁹COMMISSION ON BANKRUPTCY LAWS, *supra* note 3, at 77.

¹⁰*Id.*

¹¹*Bostwick v. United States*, 521 F.2d 741 (8th Cir. 1975).

¹²COMMISSION ON BANKRUPTCY LAWS, *supra* note 3, at 45.

¹³See Pub. L. 91-354, 84 Stat. 468 (1970).

the amount of personal debt outstanding climbed from 31 billion dollars to 338 billion dollars in the same span of years.¹⁴

A number of studies of personal bankruptcies have been conducted over the past twenty years.¹⁵ In terms of marital status, the studies uniformly indicate that consumer bankrupts are more likely than the general population to be separated, divorced, or experiencing domestic difficulty. In fact, it appears that a substantial portion of all non-business bankrupts fall within that category. As noted by the Commission on the Bankruptcy Laws of the United States in its report of July 30, 1973, upon reviewing study information:

Brunner reported that 18.2% of the bankrupts in his sample were divorced, separated, or had divorces pending, as distinguished from corresponding 5% figure of the general population. Siporin states that 15 of 30 families reported serious marital conflicts. Herrmann indicated that 1/3 in his group were involved in divorce proceedings within a period 1 year prior to or one year after the date of the petition. Mathews similarly reported that 33% were experiencing or had experienced marital difficulty. The Brooks statistics showed that 24.7 percent of the debtors had been divorced or were divorced at the time of filing. The Brookings Report represented six percent of its sample as separated and nine percent as divorced. Stabler reported that 36 percent of the bankrupts, as distinguished from 19.3 percent of his control group, had been previously married.¹⁶

To this second basic concept, rehabilitation of the debtor, the law has appended numerous exceptions resulting from competing ideas and interests which have been allowed to override the idea of a fresh start. The evolution of bankruptcy law has established a pattern whereby discharge is increasingly available to the honest debt-

¹⁴D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 25 (1971).

¹⁵G. Brooks, *Report of Bankruptcy Statistics in Southern District of Indiana*, 1973 (unpublished); G. Brunner, *Personal Bankruptcies: Trends and Characteristics*, (Bur. of Bus. Res. Monograph No. 124, Ohio State Univ., 1965); R. Herrman, *Casual Factors in Bankruptcy: A Case Study*, (Inst. of Gov't Affairs Occasional Paper No. 6, Univ. of Calif., Davis, 1965); H. Mathews, *Causes of Personal Bankruptcies*, (Bur. of Bus. Res. Monograph No. 133, Ohio State Univ., 1969); D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM, ch. 4 (1971); M. Siporin, *Family Problem Solving and Wage Earner Families*, (unpublished study, 1963), synopsized in *A Study of Bankruptcy Court Debtors*, 20 PERS. FIN. L.Q. REV. 92, (1966); G. Stabler, *The Experience of Bankruptcy*, (Credit Ass'n of Rockford, Ill., 1966), as reported in J. Lee, Senate Comm. on the Judiciary, 92d Cong., 1st Sess., *Bankruptcy Study Plan* 14-16 (Comm. Print 1971).

These studies are referred to in COMMISSION ON BANKRUPTCY LAWS, *supra* note 3, at 70.

¹⁶COMMISSION ON BANKRUPTCY LAWS, *supra* note 3, at 53 (footnotes omitted).

or, with a parallel development that the number of obligations not affected by bankruptcy discharge is gradually increasing.¹⁷ The honest debtor will receive a discharge almost as a matter of right, but that discharge may not relieve him of many of the troublesome burdens which plague society in today's complex and competitive world.¹⁸ Thus, bankruptcy courts increasingly must address the multiple problems of daily and family life affected by discharge.¹⁹

Social attitudes about the family have also undergone dramatic change in the past few decades. The pattern of divorce laws has grown from relatively restrictive legislation to the present no-fault divorce statutes.²⁰ Since 1970 more than thirty states have adopted a system of no-fault divorce or have added no-fault grounds to their existing divorce statutes.²¹ Indiana joined this revolution in 1973.²²

For a number of reasons, the female in mid-twentieth century society is not entirely dependent on the male. Today, when a woman marries, she does not lose her independence and identity, as she once did. The number of double-income families has continually increased in recent decades.²³ Women no longer necessarily lose their earning power as a result of marriage and, therefore, may not be rendered destitute by the loss of a husband through divorce. One might also read into modern divorce and remarriage statutes the suspicion that the concept of the "used woman" has changed or is changing. To the ancient Anglo-Saxon notion that for each woman there is but one man, one may now add "one at a time."²⁴ While in many states the idea of a continuing obligation by a husband to a divorced wife is changing, federal bankruptcy law has not changed relative to family obligations.

As early as 1904, the United States Supreme Court in *Wetmore v. Markoe*²⁵ asserted:

The bankruptcy law should receive such an interpretation as will effectuate its beneficent purposes and not name it an instrument to deprive dependent wife and children of the support and maintenance due them from the husband and father, which it has ever been the purpose of the law to enforce. Systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has

¹⁷Loiseaux, *supra* note 1, at 27.

¹⁸*Id.*

¹⁹See *id.* at 28.

²⁰See *id.* at 27.

²¹Note, *Alimony in Indiana Under No-Fault Divorce*, 50 IND. L.J. 541 (1975).

²²IND. CODE §§ 31-1-11.5-1 to 24 (1976).

²³Loiseaux, *supra* note 1, at 28.

²⁴*Id.*

²⁵196 U.S. 68 (1904).

become oppressive and to permit him to have a fresh start in business or commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes. Unless positively required by direct enactment the courts should not pressure a design on the part of Congress in relieving the unfortunate debtor to make the law a means of avoiding enforcement of the obligation, moral and legal, devolved upon the husband to support his wife and to maintain and educate his children.²⁶

There has been a continuing conflict between the concept of giving the debtor a fresh start, as espoused by the bankruptcy law, and the debtor's continuing obligations and duties to his family as reflected in federal and state court decisions. This conflict is evident in the courts' attempted application of section 17a(7) of the Bankruptcy Act to family law situations.

II. THE BANKRUPTCY ACT AND INDIANA CASE LAW

Section 17a(7) of the Bankruptcy Act provides: "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . . are for alimony due or to become due, or for maintenance or support of wife or child . . ."²⁷

When it is apparent that a divorce is inevitable, it is common for a husband, wife, and their representatives to negotiate a settlement agreement, which is then attached or incorporated into the decree. Such agreements take a variety of forms in an attempt to deal with the future rights and property of the spouses. The agreement may include nothing more than a division of the presently-owned prop-

²⁶*Id.* at 77.

²⁷Bankruptcy Act § 17a(7), 11 U.S.C. § 35a(7) (1976). On November 6, 1978, Congress enacted a new codification of bankruptcy law, the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979) (to be codified at 11 U.S.C. §§ 101-151326). Section 17a(7) of the present Act will be replaced by § 523(a)(5) of the new code:

- (a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt
-
- (5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree, or property settlement agreement, but not to the extent that—
 - (A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise; or
 - (B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support;

This language does not specifically alter the thrust of § 17a(7).

erties of the parties, or it may make provision for future payments to the wife and child.²⁸ If the parties have not been able to agree prior to the final divorce hearing, the court will enter a decree or order establishing the rights of the parties to the property accumulated and providing for the future obligations of the husband in a manner consistent with state law.²⁹

In the event of the husband's bankruptcy, the exact nature of the settlement agreement or decree is often at issue in applying section 17a(7) of the Bankruptcy Act. The problem is to place the obligations in the appropriate legal pigeonhole.³⁰

"Alimony," as used in section 17a(7), is generally agreed to be an allowance from a divorced husband's estate made to the divorced wife for her maintenance and support.³¹ If a debt is determined to be one arising as an element of a property settlement, normally it is dischargeable in bankruptcy.³² The difficulty, however, arises in determining whether the language used in property settlement agreements refers to the type of obligation contemplated by the term "alimony" used in the Bankruptcy Act.

The recent case of *Nichols v. Hensler*,³³ which supposedly is dispositive of the issue in Indiana,³⁴ is demonstrative of the problem. In that controversy, the former wife of the bankrupt had initiated supplemental proceedings to collect a judgment for arrearages in alimony. The United States District Court for the Southern District of Indiana held that the obligation to make payments to a former wife pursuant to the property settlement agreement was not discharged in bankruptcy. The husband appealed.³⁵

Before the entry of the divorce decree, the parties had entered into a written "Property Settlement Agreement."³⁶ The agreement had allocated specifically described property, including real estate,

²⁸See, e.g., IND. CODE § 31-1-11.5-10 (1976).

²⁹See, e.g., *id.* § 31-1-11.5-9.

³⁰The difficulty in interpretation and application stems from the variety of meanings given the terms "alimony" and "property settlement" in the legislation and case law of the various states and in the intentional or unintentional misuse of those terms as labels in divorce settlement agreements.

³¹See *Norris v. Norris*, 324 F.2d 826 (9th Cir. 1963); *In re Baldwin*, 250 F. Supp. 533 (D. Neb. 1966); 1A COLLIER ON BANKRUPTCY ¶ 17.18, at 1669-70 (14th ed. 1977 rev.); 3A COLLIER ON BANKRUPTCY ¶ 63.13, at 1839 (14th ed. 1977 rev.).

³²*Caldwell v. Armstrong*, 342 F.2d 485 (10th Cir. 1965); *Goggans v. Osborn*, 237 F.2d 186 (9th Cir. 1956).

³³528 F.2d 304 (7th Cir. 1976).

³⁴Accord, *In re Woods*, 561 F.2d 27 (7th Cir. 1977); *In re Boswell*, No. 76-2118 (7th Cir. Apr. 20, 1977).

³⁵528 F.2d at 304.

³⁶*Id.* at 305. The parties specifically titled their accord "Property Settlement Agreement."

securities, automobiles, and insurance policies, between the husband and wife. In addition, after providing for adjusting payments of cash from one party to the other, the agreement had provided:

The Husband shall pay to the Wife a sum certain of One Hundred Twenty-One Thousand Dollars (\$121,000.00) in equal monthly installments of One Thousand Dollars (\$1,000.00) each, the first installment of which shall be due and payable on or before the first day each calendar month thereafter, until One Hundred Twenty-One (121) of such installments have been paid; and it shall be agreed between Husband and Wife that the sum of Two Hundred Fifty Dollars (\$250.00) of each said monthly installments shall be considered as payment to Wife for the support and maintenance of such minor children as shall be in her care and custody; the balance of such monthly installments shall be considered as payment by Husband to Wife for and as payment of alimony.³⁷

The divorce decree recited that, in the agreement, the parties had agreed "to divide all of the marital property,"³⁸ subject to the court's approval and the entry of the divorce decree. In addition, the decree found the agreement to be "a fair and equitable division of the marital property"³⁹ and incorporated the agreement by reference.⁴⁰

Despite the express description of the obligation created by paragraph eleven of the agreement as "alimony," the husband maintained: "Section 17a(7) does not except the obligation from discharge, because, under the terms of the divorce decree and in the view of alimony taken by Indiana law, the obligation was incurred as an element of a property settlement rather than as support for the former wife."⁴¹

The Seventh Circuit Court of Appeals described the controlling issue as being "whether the term 'alimony' as used in the agreement . . . refers to the type of obligation contemplated by the term 'alimony' used in the Bankruptcy Act"⁴² (*i.e.*, income and support for a former wife). To resolve that question, the court found that, because Indiana was the situs of the divorce, its law was determinative.⁴³

³⁷*Id.*

³⁸*Id.* at 306.

³⁹*Id.*

⁴⁰*Id.*

⁴¹*Id.* at 307.

⁴²*Id.*

⁴³*Id.* at 308.

The court pointed out that the applicable Indiana decisions were not entirely clear.

There are cases which adopt the conventional definition of alimony as "an allowance out of the divorced husband's estate made the divorced wife for her support and maintenance." A second line of cases derives its authority from the decision of the Indiana Supreme Court in *Shula v. Shula*, "Alimony is awarded in Indiana for the purpose of making a present and complete settlement of the property rights of the parties." It does not include future support of wife, nor is it intended as a medium for providing financial compensation for injured sensitivities during marriage. The primary factor in fixing alimony is the existing property of parties⁴⁴

Following a somewhat detailed review of all of the pertinent Indiana case law,⁴⁵ the court concluded: "It thus appears that one proper consideration, among others, for an award of alimony in Indiana has been the relative income of the wife. An allocation to the wife on that basis is tantamount to an allowance for support."⁴⁶ In applying its conclusion to the subject settlement agreement, the court found that the labels used in the agreement were not dispositive, but the basis for the creation of the obligation determined whether the parties intended an equalization of property rights or they intended the agreement to be one for support and maintenance.⁴⁷ The court then remanded the case to the district court for further hearing relative to whether the alimony awarded under the agreement represented a further division of marital property or was based upon the income of the parties.⁴⁸

The decision established two precedents for the Seventh Circuit. First, in following the lead of other circuits,⁴⁹ the court decided that

⁴⁴*Id.* at 308-09 (citations omitted).

⁴⁵*Id.* at 307-08 (citing *McDaniel v. McDaniel*, 245 Ind. 551, 201 N.E.2d 215 (1964); *Shula v. Shula*, 235 Ind. 210, 132 N.E.2d 612 (1956); *Wellington v. Wellington*, 158 Ind. App. 649, 304 N.E.2d 347 (1974); *Doner v. Doner*, 158 Ind. App. 306, 302 N.E.2d 511 (1973); *Sidebottom v. Sidebottom*, 140 Ind. App. 657, 225 N.E.2d 772 (1967), *rev'd on other grounds*, 249 Ind. 572, 233 N.E.2d 667 (1968); *Smith v. Smith*, 131 Ind. App. 38, 169 N.E.2d 130 (1960); *Wallace v. Wallace*, 123 Ind. App. 454, 110 N.E.2d 514 (1953); *Ceiga v. Ceiga*, 114 Ind. App. 205, 51 N.E.2d 493 (1943); *Rariden v. Rariden*, 33 Ind. App. 284, 70 N.E. 398 (1904)).

⁴⁶528 F.2d at 308.

⁴⁷*Id.* at 309.

⁴⁸*Id.*

⁴⁹*In re Nunnally*, 506 F.2d 1024 (5th Cir. 1975); *In re Waller*, 494 F.2d 447 (6th Cir. 1974); *Martin v. Henley*, 452 F.2d 295 (9th Cir. 1971); *Caldwell v. Armstrong*, 342 F.2d 485 (10th Cir. 1965); *Norris v. Norris*, 324 F.2d 826 (9th Cir. 1963); *Poolman v. Poolman*,

in determining the nature of the husband's obligation, the court must refer to the divorce law of the state in which the divorce was granted to find the relevant considerations in determining the settlement.⁵⁰ Second, the court concluded that an Indiana property settlement may have elements of Bankruptcy Act "alimony" which would render such an obligation nondischargeable.⁵¹

Two subsequent decisions have cited *Nichols v. Hensler* as controlling in Indiana. In *In re Boswell*,⁵² the ex-wife had been granted an alimony judgment of \$13,100, due in \$25 weekly payments, the district court found the payments to be for the "maintenance and support"⁵³ of the ex-wife "rather than a property settlement and thus nondischargeable under Section 17a(7) of the Bankruptcy Act."⁵⁴ The court refused to certify the question of whether alimony can be construed as future support to the Indiana Supreme Court because it said that the issue was decided in *Nichols v. Hensler* and no "Indiana cases decided since *Nichols* have called into question the *Nichols* holding."⁵⁵ The decision, stamped "unpublished order not to be cited," is interesting because it provides the insight that the Seventh Circuit Court of Appeals, even after the *Nichols* decision, was not certain of the role of Indiana law in the section 17a(7) decision-making process. The court noted in its written opinion that, under some circumstances, it might be appropriate to refer the question to the state court for its interpretation.⁵⁶

In the most recent Seventh Circuit Court decision, *In re Woods*,⁵⁷ dealing with the dischargeability of alimony under section 17a(7), the court said: "The law of Indiana, determines whether Woods' assumption of the parties' debts is to be construed as dividing the marital property or as providing support"⁵⁸ Apparently, however, the court considered only Indiana law in determining the intent of the parties, rather than using the law to determine substantively whether the debt owed to the ex-wife was dischargeable in bankruptcy. In this case, the disparity between the wife's income and the husband's income at the time of the divorce was only thirty-eight dollars per week. Such a disparity was not so

289 F.2d 332 (8th Cir. 1961); *Golden v. Golden*, 411 F. Supp. 1076 (S.D.N.Y. 1976); *In re Baldwin*, 250 F. Supp. 533 (D. Neb. 1966).

⁵⁰528 F.2d at 308-09.

⁵¹*Id.*

⁵²No. 76-2118 (7th Cir. Apr. 20, 1977).

⁵³*Id.*, slip op., at 1.

⁵⁴*Id.*

⁵⁵*Id.* at 3.

⁵⁶*Id.* at 2.

⁵⁷561 F.2d 27 (7th Cir. 1977).

⁵⁸*Id.* at 29-30.

gross as to be "tantamount to an allowance for support."⁵⁹ Again the court cited *Nichols* as controlling.⁶⁰

III. INDIANA DISSOLUTION OF MARRIAGE ACT

A cursory reading of *Nichols* seems to indicate that in applying section 17a(7) the bankruptcy court is bound to apply the state's definition of the term "alimony."⁶¹ This impression was also left by a number of circuits.⁶² The *Nichols* decision and those following it have raised serious questions within the practicing bar⁶³ as to the effect of section 17a(7) when viewed against the background of Indiana's present Dissolution of Marriage Act.⁶⁴ The Act had been enacted at the time of the court's decision in *Nichols v. Hensler*, but was not applicable.⁶⁵

The statute provides:

In an action pursuant to section 3(a) [subsection (a) of section 31-1-11.5-3], the court shall divide the property of the parties, whether owned by either spouse prior to the marriage, acquired by either spouse in his or her own right after the marriage and prior to final separation of the parties, or acquired by their joint efforts, in a just and reasonable manner, either by division of the property in kind, or by setting the same or parts thereof over to one [1] of the spouses and requiring either to pay such sum as may be just and proper, or by ordering the sale of the same under conditions as the court may prescribe and dividing the proceeds of such sale.

In determining what is just and reasonable the court shall consider the following factors:

⁵⁹*Id.* at 30.

⁶⁰*Id.*

⁶¹See 528 F.2d at 307. The court spends considerable time reviewing the definition of alimony and property settlement as derived from Indiana case law. In reaching its conclusion, however, the court does not appear to have applied Indiana law.

⁶²*In re Nunnally*, 506 F.2d 1024 (5th Cir. 1975); *In re Waller*, 494 F.2d 447 (6th Cir. 1974); *Martin v. Henley*, 452 F.2d 295 (9th Cir. 1971); *Caldwell v. Armstrong*, 342 F.2d 485 (10th Cir. 1965); *Norris v. Norris*, 324 F.2d 826 (9th Cir. 1963); *Poolman v. Poolman*, 289 F.2d 332 (8th Cir. 1961); *Golden v. Golden*, 411 F. Supp. 1076 (S.D.N.Y. 1976); *In re Baldwin*, 250 F. Supp. 533 (D. Neb. 1966).

⁶³During the most recent bankruptcy law seminars (1976-77) conducted by the Indiana Continuing Legal Education Forum in the Indiana cities of Bloomington, Indianapolis, Marion, Gary, Fort Wayne, New Albany and Evansville, the issue was repeatedly raised. Interviews with Edward Hopper, partner in the law firm of Hopper & Opperman; David Kleiman, partner in the law firm of Dann Pecar Newman Talesnick & Kleiman; and Steven Ancel, partner in the law firm of Ancel Friedlander Miroff & Ancel, in Indianapolis (June 15, 1977).

⁶⁴IND. CODE §§ 31-1-11.5-1 to 24 (1976).

⁶⁵See 528 F.2d at 307.

- (a) the contribution of each spouse to the acquisition of the property, including the contribution of a spouse as homemaker;
- (b) the extent to which the property was acquired by each spouse prior to the marriage or through inheritance or gift;
- (c) the economic circumstances of the spouse at the time the disposition of the property is to become effective, including the desirability of awarding the family residence or the right to dwell therein for such periods as the court may deem just to the spouse having custody of any children;
- (d) the conduct of the parties during the marriage as related to the disposition or dissipation of their property;
- (e) *the earnings or earning ability of the parties as related to a final division of property and final determination of the property rights of the parties.*⁶⁶

In addition the Act states:

*The court may make no provision for maintenance except that when the court finds a spouse to be physically or mentally incapacitated to the extent that the ability of such incapacitated spouse to support himself or herself is materially affected, the court may make provision for the maintenance of said spouse during any such incapacity, subject to further order of the court.*⁶⁷

In the next section, however, the statute provides:

To promote the amicable settlement of disputes that have arisen or may arise between the parties to a marriage attendant upon dissolution of their marriage, *the parties may agree in writing to the provisions for the maintenance of either of them, the disposition of any property owned by either or both of them and the custody and support of their children.*⁶⁸

The concern advanced is that, given the express prohibition by the legislature with respect to an award of maintenance unless there is a written agreement or incapacitation and the subsequent narrow interpretation given the law by the only appellate court decision under the Indiana Dissolution of Marriage Act, it is possible that an Indiana divorced spouse may never again find protection from a bankruptcy discharge under section 17a(7) of the Bankruptcy Act

⁶⁶IND. CODE § 31-1-11.5-11 (1976) (emphasis added).

⁶⁷*Id.* § 31-1-11.5-9(c) (emphasis added).

⁶⁸*Id.* § 31-1-11.5-10(a) (emphasis added).

because alimony may not be granted to a divorced spouse in Indiana. Certainly it would be unfair to impose such a penalty upon Indiana residents while citizens of the other forty-nine states labor under no such disability.

IV. THE EFFECT OF INDIANA CASE LAW UNDER THE DISSOLUTION OF MARRIAGE ACT IN INTERPRETING SECTION 17a(7)

One of the few cases decided under the Dissolution of Marriage Act is *Wilcox v. Wilcox*.⁶⁹ In that case, the parties were married in 1949 during their final year as college students. While both parties had graduated, only the husband had continued his education, receiving his Doctor of Philosophy degree in 1952. The wife had worked to support the husband during that time so that he could continue his education. The wife had not been employed outside the home after the husband had received his doctorate. During that period, she had raised their three children. All the offspring had been emancipated at the time of the divorce. Dr. Wilcox was a tenured professor at Purdue University where he had been continuously employed since receiving his advanced degree.

The parties were unable to agree to a property settlement before trial and, after a hearing, the court awarded the entire marital assets of \$42,000 to the wife. The wife appealed the decision alleging that the court abused its discretion in not taking into consideration the husband's discounted future income as a marital asset to be divided as part of the property settlement. The husband cross-appealed alleging error in the distribution of the total marital assets to the wife.

In affirming the lower court's decision, the Indiana Court of Appeals, stated:

When determining what is to be divided there is nothing in the statute which lends itself to the interpretation that future income is "property" and therefore divisible. It appears that a vested present interest must exist for the item to come within the ambit of "marital assets." We cannot say that Gerald has a vested present interest in his future earnings and the legislature cannot be said to have considered it as such.⁷⁰

The opinion further stated:

To allow the discounting of a future stream of income to be called "property" runs contra to the statutory provisions

⁶⁹365 N.E.2d 792 (Ind. Ct. App. 1977).

⁷⁰*Id.* at 795.

forbidding maintenance without a showing of incapacitation. *Regardless of the label attached to an award above the value of the marital assets, its true nature would shine through as maintenance. Therefore, absent a showing of incapacitation by Gloria, she may not receive maintenance, regardless of the label she attempts to attach to the requested award.*⁷¹

V. FEDERAL QUESTION

It appears, however, that the concern of the practicing bar over the direction of Indiana law as related to section 17a(7) is unfounded. The specific circumstances which will be controlling in determining the applicability of section 17a(7) is a federal question to be established substantively by the federal courts. Federal bankruptcy legislation was enacted because of the growing dissatisfaction with the hodgepodge of insolvency laws emerging in the states and the resulting desire for national uniformity in bankruptcy relief and administration.⁷² At the Senate debate on the adoption of the 1938 revision of the Bankruptcy Act, Senator Joseph O'Mahoney stated:

[I]t is interesting to recall the striking fact that when the Constitution of the United States was adopted one of the powers granted the Central Federal Government was the power to pass a uniform national bankruptcy act. I suppose nothing is more local or individual than a person's debts; yet the framers of the Constitution, in presenting that instrument to the people of the United States, decreed that the Central Government should have complete control of bankruptcy.⁷³

The controlling principle that any state legislation which frustrates the full effectiveness of a federal law is rendered invalid by the supremacy clause of the Constitution⁷⁴ is well established.⁷⁵ The doctrine of *Erie R.R. v. Tompkins*⁷⁶ requires the application of state substantive law only in cases where federal court jurisdiction is based upon diversity of citizenship.⁷⁷ Federal law alone is applied

⁷¹*Id.* (citations omitted) (emphasis added).

⁷²Shimm, *Impact of State Law on Bankruptcy*, 1971 DUKE L.J. 879.

⁷³83 CONG. REC. 8679 (1938).

⁷⁴U.S. CONST. art. VI, cl. 2.

⁷⁵Perez v. Campbell, 402 U.S. 637 (1971).

⁷⁶304 U.S. 64 (1938).

⁷⁷In matters coming before the federal court under the concepts of ancillary or pendent jurisdiction, the court also applies substantive state law. See *Hurn v. Oursler*, 289 U.S. 238 (1933); *Moore v. New York Cotton Exch.*, 270 U.S. 593 (1926).

to any issue arising in areas where federal power is "exclusive." Bankruptcy is recognized as such an area.⁷⁸ In these areas there is federal common law.⁷⁹ Clearly, with respect to the Bankruptcy Act, the courts do not have to look to state law to determine a state definition of alimony, any more than the courts have been obligated to adopt the state definition of insolvency.⁸⁰ As was noted by the Second Circuit Court of Appeals in *Fore Improvement Corp. v. Selig*,⁸¹ "Congress is not required to direct the federal courts to look to state law for the definition of state-created rights asserted in bankruptcy, as it is when federal jurisdiction rests solely on diversity of citizenship."⁸²

That the federal courts are free to establish the standards for the application of section 17a(7) without reference to state law is also reinforced by the fact that Congress has not expressly directed the application of state law in this section as it specifically has done with respect to issues of exemptions,⁸³ claims for taxes,⁸⁴ and claims for rents⁸⁵ under the Bankruptcy Act.

The federal judiciary has availed itself of the power to establish standards and policy relative to the application of section 17a(7). The courts have established that "alimony" as used in section 17a(7) means payment in the nature of support for a former spouse.⁸⁶ They have also established as a matter of federal precedent that, if the debt is determined to be one arising under a property settlement, it is discharged in bankruptcy.⁸⁷ Moreover, the federal courts need not be bound by labels attached by the parties in their settlement

⁷⁸Perez v. Campbell, 402 U.S. 637 (1971).

⁷⁹Federal common law is predicated upon the United States Constitution, federal statutes, treaties, and administrative regulations. See *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303 (7th Cir. 1972) cert. denied, 410 U.S. 929 (1973); *Ivy Broadcasting Co. v. American Tel. & Tel. Co.*, 391 F.2d 486 (2d Cir. 1968).

⁸⁰The Bankruptcy Act defines insolvency as liabilities in excess of assets. 11 U.S.C. § 1(19) (1976). Indiana defines insolvency as the inability of a person to pay his debts as they fall due. *Royal Academy of Beauty Culture v. Wallace*, 226 Ind. 383, 78 N.E.2d 32 (1948).

⁸¹278 F.2d 143 (2d Cir. 1960).

⁸²*Id.* at 147 (Friendly, J., concurring).

⁸³11 U.S.C. § 24 (1976).

⁸⁴*Id.* § 104.

⁸⁵*Id.*

⁸⁶See *Nichols v. Hensler*, 528 F.2d 304, 307 (7th Cir. 1976); *Norris v. Norris*, 324 F.2d 826, 828 (9th Cir. 1963); *Goggans v. Osborn*, 237 F.2d 186, 188 (9th Cir. 1956); *In re Baldwin*, 250 F. Supp. 533, 534 (D. Neb. 1966); 1A COLLIER ON BANKRUPTCY ¶ 17.23, at 1678 (14th ed. 1977 rev.); 3A COLLIER ON BANKRUPTCY ¶ 63.13, at 1839 (14th ed. 1977 rev.). See also *Wetmore v. Markoe*, 196 U.S. 68 (1904).

⁸⁷*Nichols v. Hensler*, 528 F.2d 304, 307 (7th Cir. 1976); *Caldwell v. Armstrong*, 342 F.2d 485, 488 (10th Cir. 1965); *Goggans v. Osborn*, 237 F.2d 186, 189 (9th Cir. 1956). See also *Edmondson v. Edmondson*, 242 S.W.2d 730, 736 (Mo. App. 1951).

agreements, by the state courts in their decrees or by the state legislatures in their statutes.⁸⁸ The Sixth Circuit Court of Appeals has stated: "There is no peculiar sanctity surrounding the words 'property settlement.' Bankruptcy courts sit in equity . . . and have [the] power 'to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate."⁸⁹

Although the matter is manifestly a federal question and workable federal standards have evolved against which to analyze section 17a(7) problems, the federal courts' approach to alimony has been confused and unclear. There is evidence of a reluctance to recognize the issue as a federal question and to apply federal common law. For example, the court in *In re Waller*⁹⁰ was forced to determine whether certain provisions of a divorce decree constituted dischargeable alimony. In concluding that "[t]he law of Ohio must be resorted to in order to determine what constitutes alimony, maintenance or support . . .,"⁹¹ the court relied upon *Desjardins v. Desjardins*⁹² as the controlling authority. However, *Desjardins* simply restated the proposition that, pursuant to the *Erie* doctrine, state law must be followed in diversity actions.⁹³ In fact, *Desjardins* was a diversity action wherein the court was called upon to interpret an Ohio divorce decree.

The *Waller* court, after reviewing Ohio divorce law and its uncertainty found that, in any event, a bankruptcy court is not bound by state law because it is a court of equity.⁹⁴ The court then applied the definitions established by the federal courts for alimony, support, maintenance, and property settlement under section 17a(7) to the problem before it.⁹⁵

In addition to believing that they are bound by the *Erie* doctrine, some of the federal courts' reluctance to simply treat the matter as a federal question appears to have its source in the opinion of some courts that their inquiry into the character of the alimony awarded by the state court amounts to a collateral attack on the state court judgment. The bench, in *In re Nunnally*⁹⁶ commented in a revealing footnote to its opinion:

⁸⁸*Nichols v. Hensler*, 528 F.2d 304 (7th Cir. 1976); *In re Waller*, 494 F.2d 447 (6th Cir. 1974).

⁸⁹*Avery v. Avery*, 114 F.2d 768, 770 (6th Cir. 1940) (citations omitted).

⁹⁰494 F.2d 447 (6th Cir. 1974).

⁹¹*Id.* at 448.

⁹²308 F.2d 111 (6th Cir. 1962).

⁹³See *id.* at 111, 116.

⁹⁴494 F.2d at 450.

⁹⁵*Id.* at 451.

⁹⁶506 F.2d 1024 (5th Cir. 1975).

Bankrupt contends that we cannot find the \$41,779.41 an award for support since it would then be void under Texas law as permanent alimony. . . . Although it is doubtful that this is a proper forum for bankrupt to attack the divorce decree collaterally, bankrupt's argument founders on Texas case law. . . . However, Texas courts are not quick to find that permanent alimony has been ordered, and we are Erie-bound to follow in their tracks.⁹⁷

In *Waller*, the court in dicta asserted that the bankruptcy judge "did not rule on the question of whether the bankrupt's obligation to the former wife was discharged because she was not listed as a creditor"⁹⁸ and had no knowledge of the proceeding. The court then commented that had the "[c]ourt ruled on this issue, which is peculiarly a federal question, there may have been no necessity for it to decide what constitutes alimony, maintenance and support under Ohio law, which is a question more properly to be decided by Ohio Courts."⁹⁹

Even the Seventh Circuit, in its unpublished opinion in *Boswell*¹⁰⁰ noted that there might be circumstances in a section 17a(7) determination where it would be proper to certify the question of interpretation of alimony questions to the Indiana Supreme Court for its determination.¹⁰¹

VI. THE 1970 DISCHARGEABILITY ACT

In large measure, the lack of clarity and consistency in the federal courts' application of section 17a(7) may be a result of the procedure for contesting the dischargeability of an indebtedness which was obligatory prior to the 1970 amendments to the Bankruptcy Act.¹⁰² Prior to the amendments, the general view was that the bankruptcy court only determined the right to a discharge, but did not determine the effect.¹⁰³ The question of dischargeability was properly adjudicated in a non-bankruptcy forum when the creditor sued to enforce his claim and the bankrupt plead his

⁹⁷*Id.* at 1027 n.6.

⁹⁸494 F.2d at 451.

⁹⁹*Id.* (emphasis added); See Lee, *Case Comment*, 50 AM. BANKR. L.J. 175, 176 (1976) wherein the commentator noted that the court should have decided the alimony issue as a federal question in *In re Waller*.

¹⁰⁰No. 76-2118 (7th Cir. Apr. 20, 1977).

¹⁰¹*Id.*, slip op., at 3.

¹⁰²Pub. L. No. 91-467, 84 Stat. 990, amending §§ 2a(12), 14, 15, 17, 38 & 58 of the Bankruptcy Act.

¹⁰³1A COLLIER ON BANKRUPTCY ¶ 17.28, at 1726 (14th ed. 1977 rev.).

discharge as an affirmative defense.¹⁰⁴ As a result, the issues raised by section 17a(7) were most often determined in state courts.¹⁰⁵ While the state courts were bound to follow the decisions of the United States Supreme Court because the question was a federal one,¹⁰⁶ those courts tended to emphasize the effect of the law of the situs rather than the controlling federal viewpoint. Where the issues had been raised in the federal courts, the judiciary tended to follow the lead of their local brethren. However, in 1970, Congress amended the Bankruptcy Act and gave the federal courts general jurisdiction to determine the dischargeability of each section 17a(7) debt as well as to determine the right to a general discharge.¹⁰⁷ As a result, the courts should no longer feel constrained by the state court approach.

VII. CONCLUSION

Given that the matter involves a federal question and that there is a sufficient body of federal court precedent to be relied upon, the new Indiana Dissolution of Marriage Act and subsequent court decisions thereunder should have no direct effect upon the future application of the *Nichols v. Hensler* precedent that, if the wife's income is considered in arriving at a settlement figure, it is tantamount to support and will not be dischargeable. It is clear that the facts of each particular case will control, not the then-current status of state law, either legislative or judicially-created. State law is referred to in *Nichols* solely for the purpose of understanding the actions and agreements of the parties and the decisions of the divorce court in determining whether elements of maintenance and support could be deduced from the agreement or the decree in controversy. Whether the state courts interpret Indiana divorce law liberally or strictly, the approach taken by the Seventh Circuit allows the bankruptcy court to balance the fresh start concept of the Bankruptcy Act with the need to protect family obligations consistent with the national goals established by Congress so that general uniformity in the application of section 17a(7) can prevail throughout the country.

SORELLE J. ANCEL

¹⁰⁴Watts v. Ellithorpe, 135 F.2d 1 (1st Cir. 1943); Otto v. Cooks, Inc., 113 F. Supp. 861 (D. Minn. 1953); *In re Scandiffio*, 63 F. Supp. 264 (E.D.N.Y. 1945); Pass v. Webster, 85 Ohio App. 403, 83 N.E.2d 116 (1948); 1A COLLIER ON BANKRUPTCY ¶ 17.28, at 1727 (14th ed. 1977 rev.).

¹⁰⁵Watts v. Ellithorpe, 135 F.2d 1 (1st Cir. 1943); Otto v. Cooks, Inc., 113 F. Supp. 861 (D. Minn. 1953); *In re Scandiffio*, 63 F. Supp. 264 (E.D.N.Y. 1945); Pass v. Webster, 85 Ohio App. 403, 83 N.E.2d 116 (1948); 1A COLLIER ON BANKRUPTCY ¶ 17.28, at 1727 (14th ed. 1977 rev.).

¹⁰⁶*In re Lowe*, 36 F. Supp. 772 (W.D. Ky. 1941).

¹⁰⁷11 U.S.C. § 35(c) (1976).



Indiana's Obvious Danger Rule for Products Liability

I. INTRODUCTION

Abundant Indiana authority supports the proposition that a manufacturer has a duty to guard or warn a consumer or user of concealed dangers.¹ When stating that position in *J. I. Case Co. v. Sandefur*,² the Indiana Supreme Court cited *Campo v. Scofield*³ to caution that this duty does not impose absolute liability on the manufacturer for every accident in which its product is involved. "On the other hand, there must be reasonable freedom and protection for the manufacturer. He is not an insurer against accident and is not obligated to produce only accident-proof machines. The emphasis is on the duty to avoid hidden defects or concealed dangers."⁴ The court found that the harm to Sandefur was caused by a latent defect in the design of a farm auger manufactured by defendant and affirmed liability under a negligence theory.⁵

Significantly, the *Sandefur* court did not adopt from *Campo* the entire latent defect rule, or obvious danger exception, which includes: "Accordingly, if a remote user sues a manufacturer of an article for injuries suffered, he must allege and prove the existence of a latent defect or a danger not known to plaintiff or other users."⁶ Of course, requiring a manufacturer to guard against hidden dangers does not "accordingly" relieve him of liability if, in fact, that danger is obvious. Asserting there is no liability for injury

¹See *J.I. Case Co. v. Sandefur*, 245 Ind. 213, 197 N.E.2d 519 (1964); *Gilbert v. Stone City Constr. Co.*, 357 N.E.2d 738 (Ind. Ct. App. 1976); *Nissen Trampoline Co. v. Terre Haute First Nat'l Bank*, 332 N.E.2d 820 (Ind. Ct. App. 1975), *rev'd on other grounds*, 358 N.E.2d 974 (Ind. 1976); *Dudley Sports Co. v. Schmitt*, 151 Ind. App. 217, 279 N.E.2d 266 (1972); *Cornette v. Searjeant Metal Prods., Inc.*, 147 Ind. App. 46, 258 N.E.2d 652 (1970); *Blunk v. Allis-Chalmers Mfg. Co.*, 143 Ind. App. 631, 242 N.E.2d 122 (1968).

The same rule is enunciated in federal courts applying Indiana law. See *Huff v. White Motor Corp.*, 565 F.2d 104 (7th Cir. 1977); *Latimer v. General Motors Corp.*, 535 F.2d 1020 (7th Cir. 1976); *Burton v. L.O. Smith Foundry Prods. Co.*, 529 F.2d 108 (7th Cir. 1976); *Downey v. Moore's Time-Saving Equip. Co.*, 432 F.2d 1088 (7th Cir. 1970); *Posey v. Clark Equip. Co.*, 409 F.2d 560 (7th Cir.), *cert. denied*, 396 U.S. 940 (1969); *Zahora v. Harnischfeger Corp.*, 404 F.2d 172 (7th Cir. 1968); *Indiana Nat'l Bank v. De Laval Separator Co.*, 389 F.2d 674 (7th Cir. 1968); *Schemel v. General Motors Corp.*, 384 F.2d 802 (7th Cir. 1967); *Evans v. General Motors Corp.*, 359 F.2d 822 (7th Cir. 1966); *Sills v. Massey-Ferguson, Inc.*, 296 F. Supp. 776 (N.D. Ind. 1969); *Greeno v. Clark Equip. Co.*, 237 F. Supp. 427 (N.D. Ind. 1965).

²245 Ind. 213, 197 N.E.2d 519 (1964).

³301 N.Y. 468, 95 N.E.2d 802 (1950).

⁴245 Ind. at 222, 197 N.E.2d at 523.

⁵*Id.* at 223, 197 N.E.2d at 523.

⁶301 N.Y. at 471, 95 N.E.2d at 803.

resulting from obvious dangers is a policy decision, not a logical consequence of emphasizing the manufacturer's heightened duty to protect users from concealed dangers. The illogic of such a broadly-stated obvious danger rule is revealed by noting that under the rule a manufacturer might insulate itself from liability by omitting or even *removing* the safety guards from its product so that the resulting threat of injury is fully exposed.

The limitation on the seller's duty to protect consumers and users from a product's obvious dangers originated in the law of deceit.⁷ Originally, purchasers of products were fully charged with any risks of which they might or should be aware. To recover, plaintiff had to show that defendant had suppressed or misrepresented information as to concealed risks.⁸ But this system of risk allocation harkened back to a period of simpler products and less complex economic relationships. As one court has explained: "The technological revolution has created a society that contains dangers to the individual never before contemplated. The individual must face the threat to life and limb not only from the car on the street or highway but from a massive array of hazardous mechanisms and products."⁹ By not adopting the entire obvious danger exception advanced in *Campo*, Indiana courts may have avoided the necessity, faced by other jurisdictions, such as Michigan¹⁰ and New York,¹¹ of having to reject directly this harsh and anachronistic rule.

Professor Noel has asked: "Should courts, then, protect injured customers against the absence of safety features when, as consumers, they are seldom willing to pay for such features or to tolerate less efficient performance owing to their attachment?"¹² He has found an affirmative answer in Congress' reasoning in the passage of the Consumer Product Safety Act.¹³ "[A] complex technology has diminished the consumer's ability to exercise a rational choice among risks in the market' Furthermore, the in-

⁷See 2 F. HARPER & F. JAMES, THE LAW OF TORTS 1543 (1956).

⁸*Id.*

⁹Barker v. Lull Eng'r Co., 20 Cal. 3d 413, 434-35, 573 P.2d 443, 457, 143 Cal. Rptr. 225, 239 (1978).

¹⁰See *Casey v. Gifford Wood Co.*, 61 Mich. App. 208, 213-19, 232 N.W.2d 360, 363-65 (1975) (tracing the evolution of the Michigan version of the obvious danger rule, as stated in *Fisher v. Johnson Milk Co.*, 383 Mich. 158, 174 N.W.2d 752 (1970) (which followed *Campo*), to a standard of unreasonableness and foreseeability).

¹¹*Micallef v. Miehle Co.*, 39 N.Y.2d 376, 348 N.E.2d 571, 384 N.Y.S.2d 15 (1976) (overruling *Campo v. Scofield*, 301 N.Y. 468, 95 N.E.2d 802 (1950)). See notes 149-61 *infra* and accompanying text.

¹²D. NOEL & J. PHILLIPS, PRODUCTS LIABILITY 397 (1976).

¹³Consumer Product Safety Act of 1972, Pub. L. No. 92-573, 86 Stat. 1207 (1970) (codified at 15 U.S.C. §§ 2051 to 2081 (1976)).

jury is often inflicted upon the non-consumer, such as a neighbor Finally, the costs are social in nature going far beyond the injured plaintiff."¹⁴ A rule which would assign risks without consideration of the likely social and economic consequences within a modern technological context is an anachronism. If manufacturers of products are best able to improve the safety systems of their products and are best able to spread the cost of the accidents which do occur, the modern rule places upon those manufacturers the risk of introducing into the stream of commerce a defective product which is unreasonably dangerous.

This new standard of liability, which is espoused in the *Restatement (Second) of Torts*,¹⁵ has not, however, resolved in all jurisdictions the confusion which continues to permit latent-patent distinctions to be made in cases in which manufacturers have failed to adequately guard users from unreasonably dangerous, defective designs. One basic problem flows from the definition of unreasonably dangerous defect, adopted by the drafters of the *Restatement*, which asserts that a product possesses an unreasonably dangerous defect if the product's performance is below that contemplated by the ordinary consumer with the ordinary knowledge of the community.¹⁶ There is little difficulty in applying this consumer expectation rule when the actual product, as manufactured, deviates in some significant way from the original design. Presumably, the consumer or user expects that the unit to which he is exposed will conform to the manufacturer's own design. If, in fact, it does not, and as a result he is injured, he clearly should be able to recover. But if his injury results from a *design* weakness, there may be some difficulty in determining the ordinary consumer's expectation as to a product's design.¹⁷

Courts have wrestled with the consumer expectation test and have sought to harmonize it with vestigial pre-negligence limitations, such as the latent defect rule, which are unrelated to the unreasonable danger standard mandated by section 402A of the *Restatement*. Such an effort was made in *Burton v. L.O. Smith Foundry Products Co.*,¹⁸ which purported to follow Indiana law. The court found that a manufacturer was not liable for plaintiff machine operator's injuries when the parting compound it sold was in-

¹⁴D. NOEL & J. PHILLIPS, *supra* note 12, at 397-98 (quoting FINAL REPORT OF THE NAT'L COMM'N ON PROD. SAFETY 69 (1970)).

¹⁵RESTATEMENT (SECOND) OF TORTS § 402A (1964).

¹⁶*Id.*, Comment i. See also *id.*, Comments g and h.

¹⁷See *Barker v. Lull Eng'r Co.*, 20 Cal. 3d 413, 432-33, 573 P.2d 443, 455-56, 143 Cal. Rptr. 225, 237-38 (1978).

¹⁸529 F.2d 108 (7th Cir. 1976).

advertently ignited by a maintenance man working nearby. The employer, following the defendant manufacturer's instructions, mixed the compound with kerosene. While the court noted that a less flammable solvent could have been specified, it did not consider whether the substitute solvent was in fact more expensive or whether its performance would be in any way inferior to that of kerosene. The court's holding was based solely on the finding that the dangers from kerosene are apparent. The court found no design defect because the product was not unreasonably dangerous inasmuch as it met the reasonable expectations of the ordinary consumer: "[W]e have shown that the addition of kerosene to Smith's product would form a flammable substance. Since the product behaved as the ordinary user would expect, it was no more defective than the kerosene itself."¹⁹

The ordinary consumer, however, if he has any basis at all with which to form an expectation, generally *expects* the products he uses to be designed at least as safely as the industry's art will allow within the constraints of reasonable market-utility considerations. If the consumer voluntarily chooses to accept a product below such expectations with full knowledge, understanding, and appreciation of the potential harm, he can be barred from recovery because he assumed or incurred the known risks.²⁰ By so doing, however, he does not then transform the product into one that is duly safe.

The *Burton* court's interpretation of the consumer expectation test appears to hold that the consumer expects what he gets whenever he knows what he is getting and, therefore, a known danger cannot be an unreasonable danger. No Indiana case nor any other federal decision decided under Indiana law has relieved a manufacturer from liability *solely* because the danger from his product was obvious.

Another source of confusion in applying the latent defect rule can be resolved by noting that if the danger is truly apparent to all who might use or be exposed to the product, and the danger is fully appreciated and will continue to be appreciated by the exposed classes, there may be no duty to apply a second warning in addition to the persistent obviousness of the danger. Thus, obviousness does not *limit* the manufacturer's duty to warn—rather it *discharges* that duty.

In such a case the manufacturer would appear to have several choices: (1) It can design and implement safety devices to *guard* against the danger, (2) it can withdraw the product from the stream

¹⁹*Id.* at 111.

²⁰See, e.g., *Kroger Co. v. Haun*, 379 N.E.2d 1004 (Ind. Ct. App. 1978).

of commerce, (3) it can market the product and become an insurer if the product is useful but inherently dangerous or, (4) it can market the product "as is"—if the obviousness of the danger and the ability of the user to avoid harm outweighs the burden of deploying guards. Such a product might be, for example, a knife or a match.

The obviousness of a danger clearly can go far towards reducing the likelihood of injury. That is why, in order to reduce the societal costs resulting from accidents, the *emphasis* must be on revealing and eliminating hidden dangers. Nevertheless, it is equally clear that products containing an obvious danger can still wreak fearful injury even to persons acting reasonably. By any logical standards, even obvious dangers from such products may remain unreasonably dangerous and should be considered as falling below the ordinary consumer's expectations.

Professor Wade, considering the obvious danger exception, found it fundamentally inconsistent with the unreasonably dangerous requirement of strict tort liability as applied to products:

Different from and yet sufficiently similar to the commonly known danger to be classified with it is the product which has a danger which is perfectly apparent to the user. Thus the dangers of a hoe or an axe are both matters of common knowledge and fully apparent to the user. But it is not necessarily sufficient to render a product duly safe that its dangers are obvious, especially if the dangerous condition could have been eliminated. A rotary lawn mower, for example, which had no housing to protect a user from the whirling blade would not be treated as duly safe despite the obvious character of the danger.

Note that the question here is whether the product possesses the quality of due safety, not whether the plaintiff assumed the risk or was contributorily negligent. That latter question arises for consideration only after the decision is reached that the product was not duly safe. It makes no difference whether plaintiff's fault is a valid defense to an action for strict products liability, so long as the questions as to the due safety of the product is the first one to be answered.²¹

Wade noted that the consumer expectation test, as expressed in the *Restatement*, is a contract concept inappropriate to strict torts' unreasonably dangerous defect standard.²² He suggested such a test

²¹Wade, *On the Nature of Strict Tort Liability for Products*, 44 MISS. L.J. 825, 842-43 (1973).

²²*Id.* at 833-34.

encourages the courts to ratify the acceptance of unreasonable dangers because they are expected dangers. He focused on established industry customs,²³ but the same fear would apply as easily to obvious but unreasonable dangers as shown by the *Burton* decision.

Wade proposed a seller-oriented test which would require a manufacturer with an imputed expert's knowledge of his product's danger potential to decide whether he could reasonably market the product "as is."²⁴ Because we can properly assume ordinary consumers *expect* sellers to act in this way, the Wade test and a *true* consumer expectation test are in reality the same test and, therefore, under either formulation, identical marketing, guarding, and warning decisions on the part of manufacturer-sellers should result. It would seem inescapable, therefore, that under strict tort there can be no room for an obvious danger exception, because to apply it might relieve a manufacturer from liability even though he may be marketing a "not duly safe" product.

II. DIVERSITY DECISIONS UNDER INDIANA LAW

J.I. Case Co. v. Sandefur,²⁵ relied on in subsequent cases dealing with obvious dangers, pre-dates Indiana's adoption of strict tort liability. As has been noted, *Sandefur* did not extend to the acknowledgment of an obvious danger exception in the case of a design defect. But, as will be demonstrated in this section, *Sandefur's* citation of *Campo v. Scofield*²⁶ was interpreted in later federal court decisions as approval of the exception. Whether or not that assumption has merit, the federal and Indiana courts, with the sole exception of the *Burton* court, found reasons *other* than mere obviousness of danger to support findings of liability where a manufacturer failed to use a safer design.²⁷

An important case, decided later in the same year as *Sandefur*, was *Greeneo v. Clark Equipment Co.*²⁸ The alleged defect was not described in the *Greeneo* opinion but the court held that a plaintiff under Indiana law is able to state a cause of action in strict tort if he alleges he was injured by a product introduced into the stream of commerce in defective condition.²⁹ The court noted that product "use different from or more strenuous than that contemplated to be safe

²³*Id.* at 834 n.30.

²⁴*Id.* at 834-35.

²⁵245 Ind. 213, 197 N.E.2d 519 (1964).

²⁶301 N.Y. 468, 95 N.E.2d 802 (1950).

²⁷See notes 163-67 *infra* and accompanying text.

²⁸237 F. Supp. 427 (N.D. Ind. 1965).

²⁹*Id.* at 429.

by ordinary users/consumers, that is, 'misuse,' would either refute a defective condition or causation" and plaintiff's "[i]ncurring a known and appreciated risk is likewise a defense."³⁰

The *Greeno* court continued in dicta to interpret and extend *Sandefur*:

While the Indiana Supreme Court in *Sandefur* noted the *hidden nature* of the defect in the farm combine, there was no real limitation, since the defendant company could not have been *negligent* in manufacturing a product whose danger would be perceived and appreciated by all reasonable persons exercising ordinary care. It is not *negligent* for one to manufacture and sell an axe or power saw because the dangers are obvious and the manufacturer can reasonably expect others in the exercise of ordinary prudence to perceive and appreciate the dangers.³¹

At the outset it must be emphasized that Judge Eschbach in *Greeno* stated the above quoted *negligence* doctrine *only* to explain how Indiana courts were heretofore able to find liability to plaintiffs not in privity with the seller. "[P]rivity was not required where the product was 'imminently dangerous,'"³² and products containing hidden dangers were held to be imminently dangerous. But *Sandefur* eliminated the privity requirement under negligence,³³ and *Greeno* reiterated its demise under strict tort.³⁴ Whether the obvious danger exception stated above should retain vitality under *strict tort* is left open in *Greeno*, although it must be acknowledged that *Greeno* does state that the obviousness of a danger can remove the unreasonableness of the danger even under a strict tort theory. The sharp edge of an axe is the example given, but if in fact a product's obvious danger *remained* unreasonable to the user such as the *unguarded* sharp edge of a rapidly whirling power-driven sawblade, the *Greeno* dicta does not appear to preclude liability to the manufacturer who injects a product in such condition into the stream of commerce. The seller could then escape liability for injury caused only if he could show misuse or incurred risk by the plaintiff.³⁵ In any event, the *Greeno* court was not required to decide

³⁰*Id.*

³¹*Id.* at 430.

³²*Id.*

³³"[P]ublic policy has compelled this gradual change in the common law . . . where there is no longer the usual privity of contract between the user and the maker of a manufactured machine." 245 Ind. at 222, 197 N.E.2d at 523.

³⁴237 F. Supp. at 429-33.

³⁵*Id.* at 429.

whether the defendant in that case would escape liability because the danger of his product was apparent.³⁶

In 1966, the Seventh Circuit referred to *Campo* and *Sandefur* in deciding *Evans v. General Motors Corp.*³⁷ *Campo* provided authority for dicta in *Evans* stating that a manufacturer need not "render the vehicle 'more' safe where the danger is obvious to all."³⁸ *Sandefur* was cited by the *Evans* court to show an example of a product with a *latent* defect which made the product not fit for its intended purpose.³⁹ *Evans*, like *Sandefur*, was concerned with a product having a *concealed* dangerous condition, but the defendant, General Motors, avoided liability on the ground that its product was fit for its intended purpose and, therefore, not defective because the concealed condition, a frame which did not surround the driver and, therefore, failed to protect him, could not and did not cause the accident. The *Evans* decision did not rely on an obvious danger exception simply because the alleged defect was well hidden.

It is important to note that the so called "crashworthy" exception on which the *Evans* court did rely and the obvious danger exception which was merely recited in *Evans* are both based on the concept that a manufacturer's duty to make his product duly safe may be restricted by long established limitations on that duty. In October 1977, however, the Seventh Circuit, in *Huff v. White Motor Corp.*,⁴⁰ found this limited duty concept incompatible with the unreasonably dangerous standard of section 402A—at least with respect to the "crashworthy" exception. The court in *Huff* noted that Indiana interprets "section 402A in a nonrestrictive manner with a view toward implementing the basic policy consideration justifying the imposition of strict products liability . . .".⁴¹

The court footnoted Comment c to section 402A which describes the "special responsibility" of manufacturers.⁴² The court cited Indiana cases where liability was imposed over earlier notions of limited duty.⁴³

³⁶The *Greeno* opinion was in response to defendant's motion to dismiss, which was denied. There is no further reported decision establishing liability between the parties.

³⁷359 F.2d 822, 824-25 (7th Cir. 1966).

³⁸*Id.* at 824 (quoting *Campo v. Scofield*, 301 N.Y. 468, 468, 95 N.E.2d 802, 804 (1950)). The issue in *Evans* centered on the duty to make a product "more safe." The obviousness of danger was irrelevant.

³⁹*Id.* at 825. The latency factor which was at issue in *Sandefur* was not dispositive in *Evans*.

⁴⁰565 F.2d 104 (7th Cir. 1977).

⁴¹*Id.* at 107.

⁴²*Id.* n.4 (citing RESTATEMENT (SECOND) OF TORTS § 402A, Comment c (1964)).

⁴³565 F.2d at 107 (citing *Chrysler Corp. v. Alumbaugh*, 342 N.E.2d 908 (Ind. Ct. App. 1976) (extending § 402A liability to bystanders); *Perfection Paint & Color Co. v.*

Also significant, the *Huff* court noted that Indiana courts "tend to look to the progress of this area of law in other jurisdictions."⁴⁴ From this observation, the *Huff* court reasoned that the Indiana Supreme Court would follow the current general rule, as expressed in *Larsen v. General Motors Corp.*,⁴⁵ which requires an automobile to "'provide a means of safe transportation'" not just "'a means of transportation.'"⁴⁶ Although neither the *Huff* nor the *Larsen* court was called on to deal directly with the obvious danger exception, the reasoning in these cases, which establishes the safe condition of the product at time of sale as the pre-eminent consideration in placing the risk, would seem to apply as well to any vestigial notions of limited duty such as patent-latent distinctions.

In *Schemel v. General Motors Corp.*,⁴⁷ the court considered whether an automobile manufacturer should be liable for injuries occurring when the product, an auto driven by a third party at 115 miles per hour, struck the rear of plaintiff's car. The theory of negligent design advanced by plaintiff alleged that defendant might have and should have designed the car with a maximum speed control. The court, citing *Sandefur* and *Campo*, held that defendant's duty was to "avoid hidden defects and latent or concealed dangers."⁴⁸ Reasonably enough, the court held that the speed of the car was not concealed and liability could not, therefore, be assessed on the basis of a latent defect.⁴⁹ The court relieved the defendant of liability *not on the ground that the danger was obvious*, but rather on the theory that in order for the alleged design defect (the car's high speed potential) to have caused the injury the product must have been, and was, misused—that is, used more strenuously than intended. The court held, perhaps improperly, that misuse by the plaintiff or a third party should bar plaintiff's recovery even though the misuse might have been foreseeable by defendant.⁵⁰ *Schemel*, like *Evans*, also relied on the "crashworthy" exception and, insofar as it did, it was also expressly overruled by *Huff v. White Motor Corp.*⁵¹

Konduris, 147 Ind. App. 106, 258 N.E.2d 681 (1970) (finding liability when the manufacturer provided the product free)).

⁴⁴565 F.2d at 107. The court also noted: "The direction taken by the Indiana Court of Appeals comports with the development of products liability law in other jurisdictions." *Id.* (emphasis added).

⁴⁵391 F.2d 495 (8th Cir. 1968).

⁴⁶565 F.2d at 108 (quoting *Larsen v. General Motors Corp.*, 391 F.2d at 502). For a list of the jurisdictions which follow the majority rule as stated in *Larsen*, see *Huff v. White Motor Corp.*, 565 F.2d at 110-11 app. A.

⁴⁷384 F.2d 802 (7th Cir. 1967).

⁴⁸*Id.* at 805.

⁴⁹*Id.*

⁵⁰*Id.*

⁵¹565 F.2d at 106 n.1.

The court, in *Indiana National Bank v. De Laval Separator Co.*,⁵² held that only the failure to warn by defendant should be an issue in the case. The court noted that if, in fact, the maintenance procedures employed by the plaintiff created a hidden danger of which defendant should have been made aware, there would be a duty on defendant's part to warn of that danger, although, as noted earlier, a warning of a truly obvious and appreciated danger would be redundant. The *De Laval* court found that there was no design defect, latent or patent, in the product.⁵³

In *Zahora v. Harnischfeger Corp.*,⁵⁴ the court reversed a summary judgment for defendant and held that a jury could find defendant liable for negligently failing to design a crane cab with adequate visibility characteristics. The court cited *Sandefur* to note a manufacturer's duty to avoid the design of hidden defects.⁵⁵ The court then decided that a jury could find a defect in the visibility deficiencies of the crane, although, from the description in the opinion, the product's visibility characteristics seemed readily observable. The court apparently concluded that it was the risk of harm itself that was concealed or unappreciated.

It should be noted that, if the risk of harm is found to be latent, although the defective design itself is clearly out in the open, the question then becomes: Is this open danger an appreciated danger? In discussing the obvious danger exception, Dean Prosser cited cases of "exceptional situations, where, for example, the danger is observable only upon a close inspection . . . , or the danger is one not likely to be appreciated, or to be regarded as trivial"⁵⁶ The cases include situations in which plaintiff knows the paint,⁵⁷ floor wax,⁵⁸ or detergent⁵⁹ is harmful yet does not take as much care as he might to keep it out of his eye or mouth. Defendant in such cases is charged with the duty to warn or otherwise guard the unappreciative user from the product.⁶⁰

⁵²389 F.2d 674 (7th Cir. 1968).

⁵³*Id.* at 677. *De Laval* was a negligence and implied warranty case. Therefore, the finding of a lack of design defect was expressed as follows: "The ring was made of strong steel and lasted five years and was reasonably suited for its intended use. Since there was no defect in the ring when it left the factory, there could be no breach of implied warranty of fitness." *Id.* Interestingly, another limited duty concept upheld in *De Laval* was that a manufacturer may choose his materials so long as they are not extremely weak or flimsy and concealed.

⁵⁴404 F.2d 172 (7th Cir. 1968).

⁵⁵*Id.* at 176.

⁵⁶W. PROSSER, LAW OF TORTS 649-50 (4th ed. 1971).

⁵⁷Haberly v. Reardon Co., 319 S.W.2d 859 (Mo. 1958).

⁵⁸Spruill v. Boyle-Midway, Inc., 308 F.2d 79 (4th Cir. 1962).

⁵⁹Hardy v. Proctor & Gamble Mfg. Co., 209 F.2d 124 (5th Cir. 1954).

⁶⁰See W. PROSSER, *supra* note 56 at 649-50.

Many factory accident situations can be analyzed as pregnant with unappreciated, therefore functionally latent, dangers. A further analysis might disclose that the appreciation of danger may not be constant. A standard of reasonable conduct should not require an unwavering, heightened vigilance on the part of a consumer or a user forced by the employment relationship into steady proximity with an omnipresent danger.⁶¹

In *Zahora*, an alleged breakdown in the third-party crane operator's vigilance was held not to be a basis for establishing an intervening cause sufficient to relieve the crane manufacturer of liability for negligent design.⁶² *Zahora* may stop just short of calling for the liability of manufacturers whenever unreasonably dangerous design defects in their products cause injuries, but it clearly does not call for an obvious danger exception.

In 1969, however, the Seventh Circuit in *Posey v. Clark Equipment Co.*,⁶³ stated that Indiana negligence law requires "the defect must be hidden, and not normally observable, constituting a latent danger."⁶⁴ The court cited *Sandefur* for this proposition, but, as has

⁶¹See *Merced v. Auto Pak Co.*, 533 F.2d 71, 79 (2d Cir. 1976):

Furthermore it could not be found as a matter of law that a reasonable user must have been aware of a continuing danger of injury from a ricocheting object from one isolated incident, since "[m]omentary forgetfulness is not negligence as a matter of law." *Schneider v. Miecznikowski*, 16 A.D.2d 177, 178, 226 N.Y.S.2d 944, 945 (1962). Again, "[t]he failure to have in mind the existence of a dangerous condition at the time one encounters it, even though there had been knowledge of the condition in the past, does not constitute contributory negligence as a matter of law." *Rugg v. State*, 284 App. Div. 179, 183, 131 N.Y.S.2d 2, 6 (1954).

In *Byrnes v. Mach. Co.*, 41 Mich. App. 192, 202, 200 N.W.2d 104, 109 (1972), the court stated:

It is true that plaintiff was aware of the risk and that many cases find no duty where the danger is obvious. This requirement must be considered in conjunction with the modern tort concept that awareness alone does not preclude negligence. A danger may be obvious but not appreciated. Even where a danger is appreciated, circumstances may cause it to be momentarily forgotten. It is also possible for the accident to occur even though the injured party proceeds cautiously in the face of an obvious danger.

This case was decided when Michigan purported to be following *Campo*. The court found that plaintiff, as a necessary part of his job, was compelled to work with exposed moving parts. It analogized, therefore, to cases in which plaintiff slips and falls in places where the dangers are obvious, but still recovers from the negligent defendant because plaintiff had proceeded with caution. "These cases recognize that where a party either has no alternative or chooses an alternative which does not increase the risk, he should not be precluded from placing liability on the party who has created the risk."

Id.

⁶²404 F.2d at 177.

⁶³409 F.2d 560 (7th Cir.), cert. denied, 396 U.S. 940 (1969).

⁶⁴409 F.2d at 563.

been seen, *Sandefur* simply did not go that far.⁶⁵ In any event, *Posey* is primarily a failure to warn case. The court found no such duty to warn on the part of the manufacturer because the danger of high stacking with a guardless fork lift should have been apparent to the operator and his employer. As to the alleged *design* defect—failure to install safety guards—the court recognized the multi-duty nature of fork lifts. If used for truck loading and unloading, there was no need for a permanent head guard, nor was one feasible since truck vans provide insufficient clearance. Therefore, there was a sound economic reason weighing against the quantum of danger remaining in the design which justified the manufacturer's decision to sell a product without guards for every occasion.⁶⁶ Thus, the use of the product by the operator or his employer for high stacking, without purchasing the available recommended supplementary guard, might constitute on either of their parts a misuse or incurred risk.

It should be noted that manufacturers are not absolute insurers and that factors other than safety protection are permitted to enter a reasonable design calculus. In *Roach v. Kononen*,⁶⁷ the Oregon Supreme Court listed seven factors, advanced by Professor Wade, for courts to apply in determining whether an alleged design defect is unreasonably dangerous.⁶⁸ Wade's analysis considers the product's utility, likelihood and severity of harm, availability of substitutes, the feasibility of guards, user's ability to avoid danger, awareness of danger to user because of public knowledge or warnings, and manufacturers' ability to spread the loss.⁶⁹

The *Posey* court's design defect analysis also applied balancing factors—obviousness of danger versus the economic burden of making two distinct models of fork lifts, one with fixed guards for high stacking and one without guards for truck unloading. The court concluded, reasonably enough, that marketing unguarded units with *optional* guards to be available is reasonable since the obviousness of the danger should provide sufficient *warning* of the danger.⁷⁰

⁶⁵See text accompanying notes 1-5 *supra*.

⁶⁶409 F.2d at 564. The court distinguished another Pennsylvania fork lift case, *Brandon v. Yale & Towne Mfg. Co.*, 220 F. Supp. 855 (E.D. Pa. 1963), *aff'd*, 342 F.2d 519 (3d Cir. 1965), where the potential harm was greater, where the defendant did not have safety guards available at time of sale, and where the fork lift would have been capable of feasible use if a permanent guard had been installed. Although the *Posey* court noted that the Pennsylvania case was not decided under Indiana law, this case could also be distinguished from *Posey* on the basis of a design calculus involving cost, utility, and safety factors.

⁶⁷269 Ore. 457, 525 P.2d 125 (1974).

⁶⁸*Id.* at 464, 525 P.2d at 128-29.

⁶⁹See Wade, *supra* note 21, at 837-38.

⁷⁰409 F.2d at 563-64.

In *Sills v. Massey-Ferguson, Inc.*,⁷¹ the plaintiff was a bystander injured by a bolt thrown from a lawnmower. Plaintiff alleged that the mower's design was defective and that the mower was also defective in that plaintiff did not receive an adequate warning. Defendant asserted that the hazards from his product were obvious, that the product was not defective, and that plaintiff's injuries were caused by the product's use. The court held that the question of whether a defect caused plaintiff's injuries was for the jury.⁷²

The court did state a manufacturer could discharge his duty to market a product not unreasonably dangerous in two ways: "The first is to make a product that is safe. The second is to make a product which may present some danger but in such case to give an effective warning"⁷³ Although the court did not state a preference for one approach over the other, the emphasis on *effective* and the use of the qualifier "some" before the word *danger* suggest that a manufacturer should opt for a warning, rather than a guard, only if an irreducible quantum of danger survives an economic balancing test and only if he is sure the warning will be understood and appreciated by foreseeable plaintiffs. If such an effective warning were delivered to plaintiff and he proceeded to ignore the warning, it could be a "defense that plaintiff had incurred the risk."⁷⁴ Significantly, however, the court did not hold that plaintiff will be barred as a matter of law if the hazard is found to be obvious. Indeed, the court noted that plaintiff had alleged design defects "not obviated by a warning from the manufacturer-defendant. Plaintiff should have the opportunity to present his evidence"⁷⁵

The plaintiff, in *Downey v. Moore's Time-Saving Equipment Co.*,⁷⁶ operated a commercial rug washer and was injured when a roller handle counterrotated and struck him in the eye. The court noted that under strict tort, as then interpreted in Indiana, plaintiff had the burden "to prove the existence of a latent defect"⁷⁷ The court also noted its rule in *Posey*—no duty to *warn* of an obvious danger.⁷⁸ The court found no latent defects, but did not rest its decision solely on a holding that the manufacturer had no duty to design safeguards against obvious dangers. Rather, the court looked to

⁷¹296 F. Supp. 776 (N.D. Ind. 1969).

⁷²*Id.* at 783.

⁷³*Id.* at 782.

⁷⁴*Id.*

⁷⁵*Id.* at 783.

⁷⁶432 F.2d 1088 (7th Cir. 1970).

⁷⁷*Id.* at 1093 (citing *Blunk v. Allis Chalmers Mfg. Co.*, 143 Ind. App. 631, 242 N.E.2d 122 (1968)).

⁷⁸432 F.2d at 1092.

plaintiff's conduct and found he had misused the product and had incurred the risk because he "had knowledge of the danger of counter-rotation, appreciated it or should have, and by using the mechanism with these factors voluntarily assented."⁷⁹

Finally, in *Burton*, the Seventh Circuit not only recited the obvious danger exception, but also *decided* the case, both as to warning and design defect, solely on that basis. *Schemel, Sandefur, Greeno, and Posey* are cited as authority in *Burton*.⁸⁰ As demonstrated above, these four cases do not provide an adequate foundation for such a holding. In addition, the result could have been more logically reached by resting the decision on the third party's misuse.⁸¹ When the third-party maintainence man subjected defend-

⁷⁹*Id.* at 1093.

⁸⁰529 F.2d 108, 112 (7th Cir. 1976).

⁸¹*Burton* can be analyzed as a bystander case as well as a misuse case. Although plaintiff-machine operator was using the parting compound for its intended purpose, the maintenance man simultaneously, although inadvertently, "used" this same product—when he ignited it—in a manner different from that contemplated by ordinary users. With respect to the maintenance man's use, or misuse, plaintiff became a bystander. The fact that plaintiff was also using the defendant's parting compound and was also an employee of the purchaser of the product should not be material to his claim for relief from defendant-manufacturer.

The district court had "based its summary judgment on . . . lack of defect, misuse, assumption of the risk and proximate cause." 529 F.2d at 110. The Seventh Circuit Court of Appeals made only the first ground determinative and did not consider misuse. Perhaps the court may have been troubled by the conceptual problem of treating the maintenance man's ignition of the compound as a misuse or, for that matter, as any use at all. It might have been argued that the parting compound was not actually used, but was merely present, passive, and not part of the maintenance function. There is no question, however, that certain properties of the product, when ignited, caused it to become a very active part of the event. That the product's participation was triggered inadvertently and its performance was not the result of a *directed* purpose should not negate the reality that the product was in fact put to an unintended use. The product was designed to facilitate release of objects from a molding machine and was not contemplated by the manufacturer or by ordinary users to be used as a fuel for uncontrolled ignition.

A finding, from the facts in *Burton*, that product misuse, rather than defective design, had caused plaintiff's injury would require an underlying policy determination more consistent with the unreasonably dangerous standard of section 402A than a policy which would permit the court to ignore, at the threshold of the analysis, the existence of *safer* product designs. Of course, holding that obviousness of danger is an absolute bar to recovery does avoid the necessity of dealing with the difficult question of whether a manufacturer has a duty in Indiana to guard against misuse—either foreseeable or unforeseeable. See Vargo & Leibman, *Products Liability, 1978 Survey of Recent Developments in Indiana Law*, 12 IND. L. REV. at 227, 246-47 (1978).

In a somewhat similar fact situation, the court in *Perfection Paint & Color Co. v. Konduris*, 147 Ind. App. 106, 258 N.E.2d 681 (1970), upheld a jury finding that a seller of a flammable paint removing compound was not negligent, but, nevertheless, found that the injured plaintiff may not have misused the product when he agreed to assist with the application of it in the presence of an operative water heater. The court held

ant's obviously dangerous product to blowtorch treatment, the use was far different from that intended by the manufacturer or "contemplated to be safe by ordinary users/consumers."⁸² Thus, the decision could have been rendered without reliance on the obvious danger exception or without consideration of the close question of whether the product was defectively designed. The decision appears to be an effort to turn back the clock to the days of limited duty of manufacturers. In the light of the *Huff* decision⁸³ in the following year, striking down a similar limited duty doctrine that a manufacturer has no duty to protect users against "second collisions," *Burton* might be interpreted as an anomaly or an attempt to move the pendulum back in the direction of business interests.

III. INDIANA COURT DECISIONS

The Indiana courts' product liability decisions dealing with latent-patent distinctions also rest on *J.I. Case Co. v. Sandefur*,⁸⁴ but, unlike the federal court cases, the Indiana decisions do not establish a specific obvious danger exception as applied to design defects. *Sandefur* strikes the keynote calling for emphasis on latent defects, but pointedly refrains from precluding liability in a proper case to a seller of goods which are obviously, but nevertheless, unreasonably dangerous.⁸⁵

In *Blunk v. Allis-Chalmers Manufacturing Co.*,⁸⁶ plaintiff was injured when he sought to clear a clogged corn picker without first shutting off the power. The trial court directed a verdict for

that to find a plaintiff misuse in this case would require "the defective and unreasonably dangerous lacquer reducer" to have been "used in contravention of warnings and instructions on the correct use of said product." *Id.* at 121, 258 N.E.2d at 690. The trial court had found conflicting evidence as to plaintiff's conduct in this respect and did not, therefore, direct a verdict for defendant on the ground of misuse. There was, in fact, no proof that the plaintiff had actually applied any of the product and, therefore, might not have been a user or misuser.

Although the *Konduris* court stated that the seller's misuse . . . is properly categorized as negligence," *id.* at 122, 258 N.E.2d at 691, it logically follows that in upholding the jury finding for plaintiff, in the absence of a finding of seller negligence, the court accepted a theory that a seller would be strictly liable for seller's misuse without requiring a showing that seller's conduct was negligent as well. With *Konduris* as authority, the *Burton* court should have been able to ground its decision relieving defendant-manufacturer of liability on a finding of product misuse by the purchaser's agent (maintenance man), rather than on the arbitrary obvious danger rule as applied to the product's design.

⁸²*Greenco v. Clark Equip. Co.*, 237 F. Supp. 427, 429 (N.D. Ind. 1965).

⁸³565 F.2d 104 (7th Cir. 1977). See notes 40-46 *supra* and accompanying text.

⁸⁴245 Ind. 213, 197 N.E.2d 519 (1965).

⁸⁵See notes 1-5 *supra* and accompanying text.

⁸⁶143 Ind. App. 631, 242 N.E.2d 122 (1968).

defendant-manufacturer after plaintiff had alleged negligent design in an amended complaint. Plaintiff-appellant argued that he had also stated a good claim under section 402A. While the court, in reviewing strict tort as applied to defective design, cited Illinois and Indiana cases⁸⁷ which would support plaintiff's claim, the court did not state whether the theory was applicable to the case at bar. Instead, the court upheld the directed verdict for defendant holding that the trial court could have found plaintiff contributorily negligent.⁸⁸ In discussing Indiana's incurred risk defense, the court appeared to conclude that it also would apply to the facts of this case, although incurred risk was not at all clearly distinguished by the court from a contributory negligence defense.⁸⁹

Finally, the *Blunk* court cited a pre-*Sandefur* Indiana case, *Strickler v. Sloan*,⁹⁰ which held that to show a *negligent* design, plaintiff must allege and prove the existence of a latent defect. The court in *Strickler* referred to *Chisenall v. Thompson*⁹¹ which noted that there was no need to *warn* if the danger was obvious. The *Blunk* court adopted the *Chisenall* reasoning stating: "[W]e are in full accord with the law as therein stated."⁹²

As noted, it is the duty to *guard* against obvious dangers—not the duty to *warn* that is in issue. Although *Blunk* is an early case which agreed with the proposition that a party has a "'duty to appreciate danger or threatened danger,'"⁹³ it did not relieve the defendant of liability as a matter of law because the danger was obvious, but rather it reached the question of plaintiff's conduct *after* he had perceived the danger.

In *Cornette v. Searjeant Metal Products, Inc.*,⁹⁴ the Indiana court expressly adopted section 402A. Comment c to section 402A was quoted in full with approval.⁹⁵ That comment establishes the ra-

⁸⁷*Id.* at 635, 242 N.E.2d at 124 (citing *Greeno v. Clark Equip. Co.*, 237 F. Supp. 427 (N.D. Ind. 1965); *Wright v. Massey-Harris, Inc.*, 68 Ill. App. 2d 70, 215 N.E.2d 465 (1966)).

⁸⁸143 Ind. App. at 642, 242 N.E.2d at 128.

⁸⁹*Id.* at 637-38, 242 N.E.2d at 125. Plaintiff brought this action under a negligent design theory. On appeal, he asked the court to apply strict tort rules. Although the court found that plaintiff was contributorily negligent, which is ordinarily not a defense to strict tort, it also found present all the elements of incurred risk, which is a defense.

⁹⁰127 Ind. App. 370, 141 N.E.2d 863 (1956), cited in *Blunk v. Allis-Chalmers Mfg. Co.*, 143 Ind. App. at 639, 242 N.E.2d at 126.

⁹¹363 Mo. 538, 252 S.W.2d 335 (1952), quoted in *Strickler v. Sloan*, 127 Ind. App. at 385, 141 N.E.2d at 871.

⁹²143 Ind. App. at 640, 242 N.E.2d at 127.

⁹³*Id.* at 642, 262 N.E.2d at 127 (quoting *Hunsberger v. Wyman*, 247 Ind. 369, 374, 216 N.E.2d 345, 348 (1966)).

⁹⁴147 Ind. App. 46, 258 N.E.2d 652 (1970).

⁹⁵*Id.* at 52-53, 258 N.E.2d at 656.

tionale for the special manufacturer responsibility: "[P]ublic policy demands that the burden of accidental injuries caused by products intended for consumption be placed upon those who market them."⁹⁶ The *Cornette* court, however, appeared to reject much of Comment c, concluding that section 402A should be "strictly construed and narrowly applied."⁹⁷

Judge Sharp in a concurring opinion strongly disagreed with the majority conclusion that section 402A should be strictly construed.⁹⁸ He found no authority for such a holding. On the subject of obvious dangers, he presented the example of the sharp axe to show that under both negligence and strict tort theories such a product, although capable of harm, could still be found not unreasonably dangerous because "users would contemplate the obvious dangers involved,"⁹⁹ but, as in *Sandefur* and *Greene*, Sharp's opinion cannot be read to completely negate the possibility of an injury-causing defect arising out of a design condition which, although obvious, is nevertheless unreasonably dangerous.

Cornette cannot, however, be read as an obvious danger case. The court found for defendant because plaintiff failed to prove the product was defective (punch press lacked an air filter) at time of sale.¹⁰⁰ In addition, the court accepted the trial court's finding that plaintiff had incurred the risk.¹⁰¹ The trial court found that plaintiff had the requisite knowledge and appreciation of the danger because she had observed the defect and a reasonable and prudent person with such knowledge would have appreciated the danger. Plaintiff was held to have voluntarily incurred the risk,¹⁰² not because she continued at her job assignment—such a decision may be less than voluntary¹⁰³—but because she "had adequate safety equipment available to reduce the possibility of harm which she had failed to use."¹⁰⁴

In *Dudley Sports Co. v. Schmitt*,¹⁰⁵ the court stated: "[W]e recognize the validity of the argument that a manufacturer may not be liable for obvious dangers"¹⁰⁶ The court, however, found against the manufacturer. The plaintiff, a sixteen-year-old boy who

⁹⁶RESTATEMENT (SECOND) OF TORTS § 402A, Comment c (1964).

⁹⁷147 Ind. App. at 53, 258 N.E.2d at 657.

⁹⁸*Id.* at 55, 258 N.E.2d at 658 (Sharp, J., concurring).

⁹⁹*Id.* at 57, 258 N.E.2d at 659 (Sharp, J., concurring).

¹⁰⁰*Id.* at 53, 258 N.E.2d at 657.

¹⁰¹*Id.* at 54-55, 258 N.E.2d at 657.

¹⁰²*Id.*

¹⁰³See note 61 *supra*.

¹⁰⁴147 Ind. App. at 55, 258 N.E.2d at 657.

¹⁰⁵151 Ind. App. 217, 279 N.E.2d 266 (1972).

¹⁰⁶*Id.* at 226, 279 N.E.2d at 274.

was cleaning up his high school's equipment room, was injured when he accidentally triggered the catapult on the pitching machine manufactured by defendant. Although the dangerous condition was not concealed, the court found the danger of *harm* latent because it was not easily appreciated. It also noted the absence of a safety screen, inadequate warnings, and missing operating instructions.¹⁰⁷ Other possible, but foreseeable, intervening causes were held not to be a defense under Indiana law.¹⁰⁸

It is interesting to speculate whether the *Dudley* court would have found for the defendant if the dangerous condition of the pitching machine had been more obvious to and appreciated by the boy who was daily required to clean around it.¹⁰⁹ One suspects that if latency had to be found, latency *would* have been found. In any event, despite the court's dicta, *Dudley* is not a case where a manufacturer escaped liability because of an obvious danger.

Nissen Trampoline Co. v. Terre Haute First National Bank,¹¹⁰ is a failure to warn case. A jury found for the defendant-trampoline manufacturer and the trial court granted plaintiff a new trial on the ground that the verdict was contrary to the weight of the evidence. The trial court held and the appellate court confirmed that while the product was not defectively designed, the absence of proper warnings and instructions might, nevertheless, render the product defective.¹¹¹ The court of appeals noted that "where the danger or potentiality of danger is known or should be known to the user, the duty [to warn] does not attach."¹¹² As has been noted above, there may indeed be no duty to *warn* of an obvious danger because such a measure would add not a quantum of safety to the use of the product. The same caveat is not applicable in situations involving a failure to *guard* against even a patent source of potential harm.

*Gilbert v. Stone City Construction Co.*¹¹³ presents strong support for the proposition that failure to design or deploy feasible safety devices constitutes an unreasonably dangerous defect.¹¹⁴ The leased earth roller in *Gilbert* lacked a signal to warn bystanders and lacked mirrors to aid the driver in overcoming the machine's blockage of vi-

¹⁰⁷*Id.* at 226-27, 279 N.E.2d at 274.

¹⁰⁸*Id.* at 230-31, 279 N.E.2d at 276.

¹⁰⁹For discussion of momentary forgetfulness of a known danger, see note 61 *supra*.

¹¹⁰332 N.E.2d 820 (Ind. Ct. App. 1975), *rev'd*, 358 N.E.2d 974 (Ind. 1976).

¹¹¹332 N.E.2d at 825. The supreme court reversed on the grounds that the trial court failed to make the findings necessary for the grant of a new trial. 358 N.E.2d at 978.

¹¹²332 N.E.2d at 825.

¹¹³357 N.E.2d 738 (Ind. Ct. App. 1976).

¹¹⁴*Id.* at 744-45.

sion to the rear. The court also held that an incurred risk defense is a jury question,¹¹⁵ as is the issue of "whether dangerous defects in heavy equipment are readily ascertainable by a bystander."¹¹⁶ Although this latter question might be construed as going to the question of patent-latent distinctions, the court, in support of this ruling, cited to cases in other jurisdictions which totally reject the obvious danger exception,¹¹⁷ or which require a *jury finding* that users or bystanders be cognizant of the precise risk presented by the product.¹¹⁸

The cases decided in Indiana courts have not carved out a rigid obvious danger exception as applied to design defects. Indiana courts have embraced section 402A and clearly accept the principle that manufacturers owe users and bystanders a duty to market products not unreasonably dangerous. There is no reason to conclude from the Indiana court rulings that obvious design dangers are absolutely protected in this state from a duty to *guard* if economically feasible.

IV. OTHER JURISDICTIONS

As noted by the court in *Huff v. White Motor Corp.*,¹¹⁹ Indiana looks to developing tort law in other jurisdictions. Recently, in *Gilbert v. Stone City Construction Co.*,¹²⁰ the court cited *Pike v.*

¹¹⁵*Id.* at 746.

¹¹⁶*Id.* The *Gilbert* court was not inquiring into whether the obvious danger rule should be applied to bystanders. Rather, the court asserted that it is for the jury to determine whether a reasonable bystander would have had sufficient awareness of the defect to have incurred the risk. The court stopped short of requiring the jury to find that *this* bystander had subjective awareness of the defect and appreciation of the risk it presented because under Indiana law at the time such subjective awareness was not required. The court stated: "One incurs all the normal risks of a voluntary act—so long as he knows and understands them, or if they are readily discernible by a reasonably prudent person in similar circumstances." *Id.* at 746 (citing *Cornette v. Searjeant Metal Prods., Inc.*, 147 Ind. App. 46, 258 N.E.2d 652 (1970)). Note that the court, nevertheless, required the jury to find that the reasonable bystander had perceived, appreciated, and voluntarily subjected himself to the risk before it can relieve the defendant of liability. In *Kroger Co. v. Haun*, 379 N.E.2d 1004 (Ind. Ct. App. 1978), the court required a finding that the injured plaintiff was, in fact, *subjectively* aware of the risk. Applied to *Gilbert*, the generally accepted limitation expressed in *Haun* would remove virtually all consideration of the obviousness of the danger from the incurred risk analysis.

¹¹⁷357 N.E.2d at 742-44 (citing *Wirth v. Clark Equip. Co.*, 457 F.2d 1262 (9th Cir. 1972); *Pike v. Frank G. Hough Co.*, 2 Cal. 3d 465, 467 P.2d 229, 85 Cal. Rptr. 629 (1970)).

¹¹⁸357 N.E.2d at 746 (citing *Merced v. Auto Pak Co.*, 533 F.2d 71 (2d Cir. 1976)).

¹¹⁹565 F.2d 104, 107 (7th Cir. 1977). See note 44 *supra* and accompanying text.

¹²⁰357 N.E.2d 738, 741 (Ind. Ct. App. 1976).

*Frank G. Hough Co.*¹²¹ with approval. The facts in *Pike* were strikingly similar to *Gilbert*—a bystander was injured by a backward moving earthmover which lacked mirrors. An obvious danger defense was raised in *Pike*. The California Supreme Court, quoting at length from Professors Harper and James, strongly criticized the obvious danger rule:

“[T]he bottom does not logically drop out of a negligence case against the maker when it is shown that the purchaser knew of the dangerous condition. Thus if the product is a carrot-topping machine with exposed moving parts . . . and if it would be feasible for the maker of the product to install a guard or a safety release, it should be a question for the jury whether reasonable care demanded such a precaution, though its absence is obvious.”¹²²

The court continued, quoting Professor Noel:

“Any definite requirement that the defect or the danger must be latent seems to revert to the concept that a chattel must be ‘inherently’ dangerous, and this concept has been replaced under the modern decisions, by the rule that the creation of any unreasonable danger is enough to establish negligence. Under the modern rule, even though the absence of a particular safety precaution is obvious, there ordinarily would be a question for the jury as to whether or not a failure to install the device creates an unreasonable risk.”¹²³

It was noted in the discussion of *Greeno v. Clark Equipment Co.*¹²⁴ that Indiana courts found latent defects created imminently dangerous conditions sufficient to bridge the privity barrier in force prior to 1965. Professor Noel appears to suggest that full acceptance of an unreasonable risk standard should also bridge any remaining obvious danger barriers.

The *Pike* court also stated: “[T]he manufacturer’s duty of care extends to all persons within the range of potential danger.”¹²⁵ This statement in *Pike* refers to bystanders, but the duty would include users with even greater force. This doctrine from *Pike* would not permit the shifting of risk from the product manufacturer to the

¹²¹2 Cal. 3d 465, 467 P.2d 229, 85 Cal. Rptr. 629 (1970).

¹²²*Id.* at 474, 467 P.2d at 235, 85 Cal. Rptr. at 635 (quoting 2 F. HARPER & F. JAMES, *supra* note 7, at 1543).

¹²³2 Cal. 3d at 474, 467 P.2d at 235, 85 Cal. Rptr. at 635 (quoting Noel, *Manufacturer’s Negligence of Design or Directions for Use of a Product*, 71 YALE L.J. 816, 838 (1962)).

¹²⁴237 F. Supp. 427 (N.D. Ind. 1965). See notes 28-36 *supra* and accompanying text.

¹²⁵2 Cal. 3d at 473, 467 P.2d at 234, 85 Cal. Rptr. at 634.

purchaser-employer, as was sanctioned by the Seventh Circuit in *Burton*.¹²⁶

Finally, *Pike* relates the obviousness of peril to "the manufacturer's defenses, not to the issue of duty."¹²⁷ This holding goes further than in other jurisdictions because, under this rule, obviousness of danger cannot, in itself, negative a finding of defect so as to take the issue from a jury. Although Indiana courts appear not ready to give all obvious danger questions to the jury, the direction of the decisions of the country's most influential jurisdictions seems to be towards imposition of higher duty requirements on manufacturers.

Wright v. Massey-Harris, Inc.,¹²⁸ cited in *Pike*,¹²⁹ is concerned with a 1953 cornpicker which injured a farm employee. The defendant in *Wright* contended that there was no latent defect, "but on the contrary . . . the danger would be obvious to anyone placing his hands in the corn husking rollers . . ."¹³⁰ The court ignored any possible obvious danger exception by applying a single standard:

Whether the design defect in the present case is of a nature upon which liability can be imposed involves the factual question of whether it creates an unreasonably dangerous condition, or, in other words, whether the product in question has lived up to the required standard of safety.

We believe that the complaint . . . states a good cause of action in negligence and also a good cause of action in strict liability . . .¹³¹

In *Dorsey v. Yoder Co.*,¹³² the defendant slitter manufacturer raised an obvious danger defense presenting a syllogism very similar to the one relied on by the *Burton* court.¹³³ The defendant Yoder stated: "'In short, as the Restatement intended, an *obvious danger*, known to the average person as such, is not an "unreasonable danger" and hence there is no liability on the manufacturer if one encounters it.'"¹³⁴

The court vigorously denounced such a rule, emphasizing that *Campo v. Scofield*¹³⁵ is not the law in Pennsylvania.¹³⁶ The court

¹²⁶See notes 18-24 *supra* and accompanying text.

¹²⁷2 Cal. 3d at 473, 467 P.2d at 234, 85 Cal. Rptr. at 634.

¹²⁸68 Ill. App. 2d 70, 215 N.E.2d 465 (1966).

¹²⁹2 Cal. 3d at 476, 467 P.2d at 236, 85 Cal. Rptr. at 636.

¹³⁰68 Ill. App. 2d at 73, 215 N.E.2d at 467.

¹³¹*Id.* at 79, 215 N.E.2d at 470.

¹³²331 F. Supp. 753 (E.D. Pa. 1971).

¹³³See text accompanying notes 18-19 *supra*.

¹³⁴331 F. Supp. 758 (quoting Brief for Defendant).

¹³⁵301 N.Y. 468, 95 N.E.2d 802 (1950).

¹³⁶331 F. Supp. at 759 (citing *Bartkewich v. Billinger*, 432 Pa. 351, 247 A.2d 603 (1968)).

quoted *Pike*, Frumer and Friedman, Harper and James, and Wade¹³⁷ to support the Pennsylvania rule that obviousness of danger is to be balanced with other design factors according to a formulation similar to that advanced by Professor Wade.¹³⁸ Thus, obviousness of danger does not automatically preclude liability in Pennsylvania, but it can explain how a sharp knife can come through a design calculus without being declared unreasonably dangerous.¹³⁹ As for the knife on the slitter in Yoder, “[t]he jury found the balance tipped in favor of plaintiff” because “a guard would not eliminate the machine’s usefulness, nor would the cost of \$200 to \$500 on an \$8,000 machine be unreasonable. Moreover, the seriousness of the potential harm was great.”¹⁴⁰

The *Dorsey* court did not deal directly with defendant’s invocation of section 402A’s consumer expectation test, except to substitute the seller-oriented test advanced by Wade.¹⁴¹

The California Supreme Court, recognizing the troublesome confusion and limitations inherent in the section 402A consumer exception test, recently formulated a new standard for design cases. In *Barker v. Lull Engineering Co.*,¹⁴² the court held it would permit plaintiff to recover:

- 1) if the plaintiff demonstrates that the product failed to perform as safely as an ordinary consumer would expect when used in an intended or reasonably foreseeable manner, or 2) if the plaintiff proves that the product’s design proximately caused his injury and the defendant fails to prove, in light of the relevant factors discussed above, that on balance the benefits of the challenged design outweigh the risk of danger inherent in such design.¹⁴³

Once again, California has extended the defendant manufacturer’s burden so that he may now have to come forward with evidence to prove his design was duly safe.

At the other end of the spectrum, of course, is the *Campo* doctrine of limited duty with its keystone of requiring plaintiff to prove

¹³⁷331 F. Supp. at 758-60 (quoting *Pike v. Frank G. Hough Co.*, 2 Cal. 3d 465, 467 P.2d 229, 85 Cal. Rptr. 629 (1970); FRUMER & FREEMAN, *PRODUCTS LIABILITY* 718-19; 2 F. HARPER & F. JAMES, *supra* note 7, § 28.6 (1956); Wade, *Strict Liability of Manufacturers*, 19 Sw. L.J. 5, 17 (1965).

¹³⁸See text accompanying note 21 *supra*. See also Keeton, *Manufacturer’s Liability: The Meaning of “Defect” in Manufacture and Design of Products*, 20 SYRACUSE L. REV. 559 (1969).

¹³⁹331 F. Supp. at 760.

¹⁴⁰*Id.*

¹⁴¹*Id.* See text accompanying note 21 *supra*.

¹⁴²20 Cal. 3d 413, 573 P.2d 443, 143 Cal. Rptr. 413 (1978).

¹⁴³*Id.* at 435, 573 P.2d at 452, 143 Cal. Rptr. at 239-40.

a latent danger.¹⁴⁴ New York has wrestled with this rule since 1950, and its judiciary has steadily restricted its scope. In *Bolm v. Triumph Corp.*,¹⁴⁵ the court distinguished the obviousness of the *condition* from the obviousness of the *danger* and held a determination of the latter was a jury question.¹⁴⁶ In *Merced v. Auto Pak Co.*,¹⁴⁷ the court required the jury to find that the "precise risk" was obvious, not merely that the generally dangerous condition was obvious. In that case, plaintiff was injured by a trash compactor. Although the dangers of a trash compactor may have been obvious, the court stated it was for the jury to determine whether the *specific* peril which led to plaintiff's injuries was, in fact, a hidden danger.¹⁴⁸

Finally, in *Micallef v. Miehle Co.*,¹⁴⁹ the court stated: "The time has come to depart from the patent danger rule enunciated in *Campo v. Scofield . . .*".¹⁵⁰ The court then dealt with the following issues. First, should the courts or the legislature be responsible for controlling obvious dangers in products? The court answered this question indirectly by stating that the manufacturer's duty is to "exercise that degree of care in his plan or design so as to avoid any unreasonable risk of harm . . .".¹⁵¹ Obviously, the legislature cannot pre-regulate conduct to achieve this result. Legislation must be strictly construed and, therefore, many fact situations will fall outside the statutes. New products, modified products, and new uses for products will create situations in which risk occurs, but which the regulations fail to cover. Clearly, the court must supplement regulations by looking back through the events to determine whether the general standards of conduct and conditions of product safety have been met by the parties.¹⁵²

¹⁴⁴See notes 2-6 *supra* and accompanying text.

¹⁴⁵33 N.Y.2d 151, 305 N.E.2d 769, 350 N.Y.S.2d 644 (1973).

¹⁴⁶*Id.* at 160, 305 N.E.2d at 774, 350 N.Y.S.2d at 651. "Here the duty and, thus, the liability of the manufacturer turn upon the perception of the reasonable user of the motorcycle as to the dangers which inhere in the placement of the parcel grid That is a question of fact . . . for jury consideration." *Id.* The test here is very similar to the one posited in *Gilbert*. See note 116 *supra*. The patent-latent distinction is not completely rejected, but obviousness is to be considered by a jury through the plaintiff's eyes or through the eyes of a reasonable person *similarly* situated.

¹⁴⁷533 F.2d 71 (2d Cir. 1976).

¹⁴⁸*Id.* at 78.

¹⁴⁹39 N.Y.2d 376, 348 N.E.2d 571, 384 N.Y.S.2d 115 (1976).

¹⁵⁰*Id.* at 379, 348 N.E.2d at 573, 384 N.Y.S.2d at 117.

¹⁵¹*Id.* at 385, 348 N.E.2d at 577, 384 N.Y.S.2d at 121.

¹⁵²The court opts for a factor balancing test to find the presence of a design defect. *Id.* at 385, 348 N.E.2d at 577-78, 384 N.Y.S.2d at 121. Clearly, the balance must be determined on a case-by-case basis following general principles which would be impossible to codify.

Second, have changing technological and social conditions created a need for a new rule?¹⁵³ Currently, products are so complex and dangerous that the obviousness of danger is less clear to the modern consumer, making him more reliant on the expertise of the manufacturer to protect him from dangers in the product. To assign this burden without equivocation to the party who can exercise the most control over the condition of the product "furthers the public interest."¹⁵⁴

Third, does the *Campo* rule encourage misdesign? The court opined: "'The manufacturer of the obviously defective product ought not to escape because the product was obviously a bad one. The law, we think, ought to discourage misdesign rather than encouraging it in its obvious form.'"¹⁵⁵

Fourth, does the *Campo* rule discourage safety devices? The court quoted:

"The asserted negligence of plaintiff—placing his hand under the ram while at the same time depressing the foot pedal—was the very eventuality the safety devices were designed to guard against. It would be anomalous to hold that defendant has a duty to install safety devices but a breach of that duty results in no liability for the very injury the duty was meant to protect against."¹⁵⁶

The court noted the inconsistency in *Campo* which "places a duty on the manufacturer to develop a reasonably safe product yet eliminates this duty, thereby granting him immunity . . . if the dangerous character of the product can be readily seen, irrespective of whether the injured user or consumer actually perceived the danger."¹⁵⁷

Fifth, does the *Campo* rule confuse the patent danger exception with assumption of risk? It is important to distinguish the policy bases for these two defenses. Assumption of risk would appear to rest on something akin to basic contract principles. The risk perpetrator (in products cases, usually the manufacturer) offers to the market, along with something useful, a quantum of danger. To

¹⁵³The court stated: "[*Campo's*] unwavering view produces harsh results in view of the difficulties in our mechanized way of life to fully perceive the scope of danger, which may ultimately be found by a court to be apparent in manufactured goods as a matter of law." 39 N.Y.2d at 385, 348 N.E.2d at 577, 384 N.Y.S.2d at 120.

¹⁵⁴*Id.* at 385, 348 N.E.2d at 577, 384 N.Y.S.2d at 121.

¹⁵⁵*Id.* at 384, 348 N.E.2d at 577, 384 N.Y.S.2d at 120 (quoting *Palmer v. Massey-Ferguson, Inc.*, 3 Wash. App. 508, 517, 476 P.2d 713, 719 (1970)).

¹⁵⁶39 N.Y.2d at 384-85, 348 N.E.2d at 577, 384 N.Y.S.2d at 120 (quoting *Bexiga v. Havar Mfg. Co.*, 60 N.J. 402, 412, 290 A.2d 281, 286 (1972)).

¹⁵⁷39 N.Y.2d at 384, 348 N.E.2d at 576, 384 N.Y.S.2d at 120.

"accept" the "offer" and legally incur the risk, the purchaser, user, or bystander must know, understand, and appreciate the risk offered. He may then complete the bargain by voluntarily assuming the risk. In a free society, parties should have the freedom to strike these bargains and courts should ratify consequences fairly anticipated and assumed by the parties.¹⁵⁸

By applying *Campo*, however, courts find assumption of risk "as a matter of law"¹⁵⁹ and the plaintiff may not show he failed to voluntarily incur the risk offered. It is as if a contract could be enforced by a party who merely shows he made an offer with no hidden loopholes but alleges no acceptance. Simply pointing out a danger he has created should not relieve an actor from a duty to do what is feasible to ameliorate that danger, unless he can show the parties accepted the conditions.

It might be argued that, where the danger is obvious, the elements of incurred risk are almost sure to be present. The *Burton* case suggests, however, that there are indeed Indiana contexts where plaintiffs might recover were it not for the obvious danger rule. Injured bystanders (such as *Burton*) could be barred from proceeding against the product seller whenever it can be found the danger was obvious to the user. Even if the plaintiff is in a position to perceive the product's unsafe condition, he may not appreciate the risk it presents. If he has fully appreciated the risk at one time, he may not have retained this appreciation at the time of injury. Finally, the plaintiff may not have truly voluntarily subjected himself to the risk. These conditions arise frequently in the employment context where industrial equipment has great damage potential, where the act of one employee often affects the safety of another, where fatigue, boredom, or momentary forgetfulness can reduce perceptions of danger, where involuntary physiological reflex actions can result in injury, and where the necessity of bringing home a paycheck may itself create an involuntary risk incurrence.

Sixth, how far does the seller's duty go?¹⁶⁰ The *Micallef* court simply accepted the design factor balancing principles discussed in several contexts previously. The court, citing *J.I. Case Co. v.*

¹⁵⁸The analogy of assumption of risk to formation of a contract through offer and acceptance can be carried too far. The assumer of a risk generally does not agree directly, either impliedly or explicitly, with the perpetrator of the danger to bear the risks therefrom. In fact, if he does so agree, his risk assumption is generally analyzed as a negation of the defendant's duty rather than the basis for an affirmative defense. The contract analogy is offered merely to illustrate the unilateral nature of the obvious danger rule.

¹⁵⁹39 N.Y.2d at 384, 348 N.E.2d at 576, 384 N.Y.S.2d at 120.

¹⁶⁰"What constitutes 'reasonable care' will, of course, vary with the surrounding circumstances . . ." *Id.* at 386, 348 N.E.2d at 577, 384 N.Y.S.2d at 121.

Sandefur,¹⁶¹ recognized: "This [duty] does not compel a manufacturer to clothe himself in the garb of an insurer in his dealings"¹⁶²

IV. CONCLUSION

If, as the *Huff* court contended, Indiana looks to other jurisdictions for guidance in developing its tort and product liability law, it will find that a solid phalanx of major jurisdictions have discarded patent-latent distinctions for a general standard of unreasonable risk which includes obviousness of danger as only one factor to be weighed in determining whether a product's design is defective. Even New York, the jurisdiction in which *Campo* was decided, has come full circle.

Indiana courts had early adopted an "emphasis on latent defects" in order to find the "imminently dangerous" products which enabled pre-*Sandefur* plaintiffs to recover without having to allege privity with the manufacturer. Ironically, this aspect of a latent defect rule was employed to increase the scope of the manufacturer's liability rather than to limit it.

Later decisions, however, especially in federal court, recited the extended *Campo* rule that held that patent defects should not trigger liability for the manufacturers. These decisions should not, however, control cases where the defect is failure to design and build in adequate safety guards because in these decisions: (1) The court was considering a duty to warn—rather than a duty to design adequate safety guards,¹⁶³ or (2) the court found there could be liability because the alleged defect was in fact latent,¹⁶⁴ or (3) the court found no liability grounding its holding on a defense other than or in addition to an obvious danger exception,¹⁶⁵ or (4) the court could have found no liability under a defense more appropriate than an obvious

¹⁶¹245 Ind. 213, 197 N.E.2d 519 (1964). See text accompanying notes 2-6 *supra*.

¹⁶²*Id.* at 386, 348 N.E.2d at 578, 384 N.Y.S.2d at 121-22.

¹⁶³See *Downey v. Moore's Time-Saving Equip. Co.*, 432 F.2d 1088 (7th Cir. 1970); *Posey v. Clark Equip. Co.*, 409 F.2d 560 (7th Cir.), *cert. denied*, 396 U.S. 940 (1969); *Indiana Nat'l Bank v. De Laval Separator Co.*, 389 F.2d 674 (7th Cir. 1968); *Nissen Trampoline Co. v. Terre Haute First Nat'l Bank*, 332 N.E.2d 820 (Ind. Ct. App. 1975), *rev'd on other grounds*, 358 N.E.2d 332 (Ind. 1976); *Blunk v. Allis-Chalmers Mfg. Co.*, 143 Ind. App. 631, 242 N.E.2d 122 (1968).

¹⁶⁴See *Zahora v. Harnischfeger Corp.*, 404 F.2d 172 (7th Cir. 1968); *J.I. Case Co. v. Sandefur*, 245 Ind. 213, 197 N.E.2d 519 (1964); *Dudley Sports Co. v. Schmitt*, 151 Ind. App. 217, 279 N.E.2d 266 (1972).

¹⁶⁵See *Downey v. Moore's Time-Saving Equip. Co.*, 432 F.2d 1088 (7th Cir. 1970); *Posey v. Clark Equip. Co.*, 409 F.2d 560 (7th Cir.), *cert. denied*, 396 U.S. 940 (1969); *Schemel v. General Motors Corp.*, 384 F.2d 802 (7th Cir. 1967); *Evans v. General Motors Corp.*, 359 F.2d 822 (7th Cir. 1966); *Cornette v. Searjeant Metal Prods., Inc.*, 147 Ind. App. 46, 258 N.E.2d 652 (1970); *Blunk v. Allis-Chalmers Mfg. Co.*, 143 Ind. App. 631, 242 N.E.2d 122 (1968).

danger exception,¹⁶⁶ or (5) the court did not determine or preclude liability in the case.¹⁶⁷

A careful reading of the cases decided under Indiana law finds no decision other than *Burton* which relieved a seller of liability *solely* because the design danger in his product was obvious. In the light of recent decisions, such a holding would now be inconsistent with the policy of *Restatement (Second) of Torts* section 402A, which calls for manufacturers to be governed by a basic standard of "unreasonably dangerous."

Although the consumer expectation test of section 402A might be interpreted to exclude obvious dangers from liability because they are within the consumer's contemplation, the better view looks to the policy basis of this section and substitutes a clearer seller-oriented rule, or simply rejects the obvious danger exception, or introduces a safety design balancing test, or supplements the consumer expectation test with additional requirements. The recent *Huff* decision in the Seventh Circuit and *Gilbert* in the Indiana Court of Appeals support the conclusion that Indiana courts are now to be guided by the underlying policy of strict tort, which is to deter sellers from marketing products not duly safe.

It is doubtful that Indiana courts ever did *fully* accept an obvious danger exception. Insofar as they might have adopted some part of that rule, any limitation of a seller's duty to *guard* against an unreasonably dangerous although obvious condition in his product appears now to have lost virtually all of its vitality.

JORDAN H. LEIBMAN

¹⁶⁶See *Burton v. L.O. Smith Foundry Prods. Co.*, 529 F.2d 108 (7th Cir. 1976).

¹⁶⁷See *Sills v. Massey-Ferguson, Inc.*, 296 F. Supp. 776 (N.D. Ind. 1969); *Greeno v. Clark Equip. Co.*, 237 F. Supp. 427 (N.D. Ind. 1965).

Appointment of a Receiver Without Notice in Indiana

I. INTRODUCTION

A receiver¹ is a court-appointed officer whose function is "to receive and preserve the property or fund in litigation . . . , when it does not seem reasonable that either party should hold it."² Although typically the court appoints a receiver after the adverse party has had an opportunity to be heard, in certain situations the rights of the moving party cannot be protected by any means short of obtaining a receivership before notice and hearing.³ The remedy affords the petitioning party immediate protection from loss or destruction of assets in the hands of an adverse party.⁴ However, if complete

¹Receiverships are generally of two types, (1) The preservation type, and (2) the liquidation type. Usually the moving party seeks a preservation receiver. For example, during the pendency of a foreclosure action, a receivership is sought to preserve the subject matter of the foreclosure until the rights of the parties are established at trial. Generally, a preservation receiver must manage the affairs of an ongoing business. The liquidation receiver, on the other hand, is typically appointed by the court only *after* a legal proceeding for the purpose of liquidating the assets of a failing business, paying the debts, and distributing anything which remains. Its function is usually similar to that of the executor of an estate. 2 R. TOWNSEND, SECURITIES AND CREDITOR'S RIGHTS 553 (1976). Because the issue of the appointment of a receiver without notice most often arises in the case of preservation receiverships, all subsequent references in this note to receivers, unless otherwise indicated, refer to preservation receiverships.

²J. HIGH, TREATISE ON THE LAW OF RECEIVERS 2 (1876).

³If a person in control of assets has time to waste or improperly apply assets, there may be little left to preserve. Indiana courts soon after the adoption of the receivership statute recognized this consideration:

The appointment of a receiver is one of the prerogatives of a court of equity, exercised in aid of its jurisdiction, in order to enable it to accomplish, as far as practicable, complete justice between the parties before it. *From the very nature of the power and of the purposes for which it may be invoked, its efficiency depends on the promptness with which it may be exercised.*

Bitting v. Ten Eyck, 85 Ind. 357, 360 (1882) (emphasis added). See also Meyering v. Petroleum Holdings Inc., 227 Ind. 313, 86 N.E.2d 78 (1949); H-A Circus Operating Corp. v. Silberstein, 215 Ind. 413, 19 N.E.2d 1013 (1939).

"The appointment of a receiver during the pendency of a lawsuit or at the commencement of legal proceedings, as in the case of a receiver appointed without notice, is for the purpose of preserving the status quo or of protecting the property pending notice and hearing. Vogel v. Chappell, 211 Ind. 310, 312-13, 6 N.E.2d 953, 955 (1937). Notwithstanding the potential for a receiver to preserve and protect the assets pending the final disposition of the legal questions, and aside from the difficulty in having a receiver appointed with notice, much less without notice, the caveat issued by the court in Indianapolis Dairymen's Co-op. v. Bottema, 226 Ind. 237, 79 N.E.2d 399 (1948), should be kept in mind by all who seek the appointment of a receiver:

[T]he power should be exercised with great caution and never indulged unless the danger of loss or injury is imminent. "*A receivership is not a*

relief is to be accorded the moving party, the rights of the party in possession must be infringed upon. Due process requires that no person will be deprived of his property without notice and hearing.⁵ There are, therefore, two competing considerations: Whether to afford full protection to the moving party at the expense of the rights of the party in possession or to accord the moving party something less than full and adequate relief with the risk that justice will be altogether thwarted.⁶

The problem is compounded because the Indiana General Assembly has not provided any legislative guidance in this area,⁷ except to specifically provide for the ex parte appointment of a receiver.⁸ The courts, therefore, are left with the task of determining when notice and hearing may be dispensed with, without

panacea for all business ills. The remedy may be worse than the disease.

Even the suggestion of a receivership, as all know, may cause capital to hide in its shell."

Id. at 245-46, 79 N.E.2d at 404 (emphasis added) (quoting 16 W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 7697, at 90 (repl. ed. 1942)). This portion of the court's opinion in *Indianapolis Dairymen's Co-op.* is significant in the discussion of receiverships without notice because: (a) It points out that a party petitioning for a receiver might be well-advised to consider an alternate course of action because a receiver is by no means the solution to all business problems, and (b) it suggests an additional reason for seeking the appointment of a receiver without notice since an unannounced take-over of the assets may prevent an unexplained "disappearance" of the assets.

⁵E.g., *Riverside & Dan River Cotton Mills v. Menefee*, 237 U.S. 189, 193 (1915).

"The courts must balance the need to protect the plaintiff's claim to the assets against the debtor's constitutional and legal rights to his property. The party seeking the appointment of a receiver clearly bears the burden of proving the need for the receivership. *Corbin v. Thompson*, 141 Ind. 128, 129, 40 N.E. 533, 533 (1895). The court in *Corbin* held:

The power of the courts to appoint receivers is one of the highest and most unusual character vested in courts of chancery, and is never exercised in doubtful or evenly balanced cases; but is exercised only where justice would in all probability be defeated by withholding it.

Id. at 129, 40 N.E. at 533. *Accord*, *Ziffrin v. Ziffrin*, 242 Ind. 351, 358, 179 N.E.2d 276, 279 (1962); *Jones v. Becker*, 212 Ind. 248, 254, 8 N.E.2d 587, 590 (1937). In addition, courts generally go a step further and require the moving party to demonstrate a probability that it will ultimately succeed on the merits. *Indianapolis Dairymen's Co-op. v. Bottema*, 226 Ind. 237, 243, 79 N.E.2d 399, 403 (1948); *Hawkins v. Aldridge*, 211 Ind. 332, 341, 7 N.E.2d 34, 38 (1937).

"The Indiana Legislature enacted the receivership statute in 1881. Act of Apr. 7, 1881, Ch. 38, § 245, 1881 Ind. Acts 240. Except for a minor change in 1911, Indiana statutory law has remained unchanged for almost the last 100 years. IND. CODE § 34-1-12-1 (1976). Furthermore, the Indiana Code adopted the principles applied by the equity courts before the formation of the Code. *Bitting v. Ten Eyck*, 85 Ind. 357, 360 (1882). *Accord*, *State ex rel. Makar v. St. Joseph County Circuit Court*, 242 Ind. 339, 347, 179 N.E.2d 285, 289 (1962) (The authority of a court to appoint a receiver exists only by statute and not at common law.).

⁸IND. CODE § 34-1-12-9 (1976).

violating the adverse party's constitutional rights.⁹ Over the years, the Indiana courts have developed a rather elaborate rule, yet there is some question whether the courts have gone far enough in protecting the rights of the party in possession. Despite the shortcomings of the court-adopted rule and the resulting constitutional questions involved in the unannounced seizure of another person's property, and despite the grave consequences which may befall the party petitioning for the appointment, parties nevertheless continue to press for ex parte receiverships because of the need for a prompt and efficient recovery of endangered property.

The issues which surround the risky practice of having a receiver appointed before notice is served will be discussed in this Note.

II. GENERAL PROCEDURE FOR APPOINTMENT OF A RECEIVER WITH NOTICE

The discussion of the appointment of a receiver before notice can be better understood by first considering the procedure for the appointment of a receiver *with* notice.

An incredible aspect of the long history¹⁰ of the receivership

⁹In attempting to protect these constitutional rights, three fundamental principles guide the courts: (1) "Relief by a receivership is an extraordinary remedy and radical in nature," Indianapolis Mach. Co. v. Curd, 247 Ind. 657, 662, 221 N.E.2d 340, 343 (1966) (*See, e.g.*, Youngstown Sheet & Tube Co. v. Patterson-Emerson-Comstock, 227 F. Supp. 208, 216 (N.D. Ind. 1963); Lafayette Realty Corp. v. Moller, 247 Ind. 433, 439, 215 N.E.2d 859, 862 (1966); Ziffrin v. Ziffrin, 242 Ind. 351, 358, 179 N.E.2d 276, 278 (1962)); *State ex rel.* Makar v. St. Joseph County Circuit Court, 242 Ind. 339, 347, 179 N.E.2d 285, 289-90 (1962)); (2) "such power should only be exercised when it is clear that no other full and adequate remedy exists whereby justice between the parties may be affected and a wrong prevented," Ziffrin v. Ziffrin, 242 Ind. 351, 358, 179 N.E.2d 276, 278 (1962); and (3) "[s]uch powers are exercised by a court of equity with due care and caution," Jones v. Becker, 212 Ind. 248, 254, 8 N.E.2d 587, 590 (1937). In considering the appointment of a receiver without notice, the courts apply these principles to the party seeking the receiver with great scrutiny. Henderson v. Reynolds, 168 Ind. 522, 526, 81 N.E. 495, 496 (1907).

Generally, in order to allow ex parte relief under these principles, it must appear that an emergency situation exists and that the delay inherent in giving notice would cause irreparable harm to the moving party. Lafayette Realty Corp. v. Moller, 237 Ind. 433, 439, 215 N.E.2d 859, 862 (1966); Meyering v. Petroleum Holdings, 227 Ind. 313, 325, 86 N.E.2d 78, 82 (1949); Largura Constr. Co. v. Super-Steel Products Co., 216 Ind. 58, 61, 22 N.E.2d 990, 992 (1939); Bookout v. Foreman, 198 Ind. 543, 546-47, 154 N.E. 387, 388 (1926).

¹⁰The receivership remedy is one of the oldest forms of equitable relief, dating from the reign of Edward VI in England. 65 AM. JUR. 2d *Receivers* § 1 (1972). The remedy was introduced into American jurisprudence with the other equity powers of early American courts. However, much of the modern law has evolved since the Industrial Revolution, which brought a boom in business and the general economic growth of the nation. Perhaps this is, in part, the problem associated with receiver-

remedy is that the Indiana General Assembly has not outlined a clear procedure for the obtaining of a receiver.¹¹ Although the vagueness of the statute enables the courts to exercise a great degree of discretion and flexibility, the lack of direction with which practitioners are left persists.

The first step in seeking the appointment of a receiver is to file a lawsuit¹² and have a summons issued to the defendant, the adverse party.¹³ The plaintiff usually alleges impropriety on the part of the person in control of the assets¹⁴ and petitions for the appointment of a receiver.¹⁵ The appointment of a receiver is an ancillary

ships. Courts in the closing years of the twentieth century are still applying legal principles developed during the infancy of business in the late 1800's. Indiana law has followed the same course.

¹¹Darby, *Need of a New Receivership Statute in Indiana*, 4 IND. L.J. 266 (1929). Darby's severe criticism of the Indiana receivership statute 50 years ago is still accurate because the statute has not been amended since he wrote: "Our receivership statute in Indiana is now 47 years old. It is obsolete and insufficient in many respects. Our circuit and superior court judges are entitled to more aid from the Legislature . . . than the present statute affords." *Id.* at 266.

¹²Winona, Warsaw, Elkhart & South Bend Traction Co. v. Collins, 162 Ind. 693, 694, 69 N.E. 998, 999 (1904).

¹³State *ex rel.* Busick v. Ewing, 230 Ind. 188, 190, 102 N.E.2d 370, 371 (1951); Alexandria Gas Co. v. Irish, 152 Ind. 535, 536, 53 N.E. 762, 763 (1899). In *Alexandria Gas Co.* the court held:

The question presented is whether the court had jurisdiction to appoint a receiver without notice, before a summons had been issued on said complaint against appellant. It is settled law in this State that in an action like this the court has jurisdiction to appoint a receiver only after the commencement of an action, and while it is pending. The process must be delivered to the officer authorized to serve it before the action is deemed commenced.

Id. at 536-37, 53 N.E. at 763 (citations omitted).

¹⁴See, e.g., Indianapolis Dairymen's Co-op. v. Bottema, 226 Ind. 237, 241-42, 79 N.E.2d 399, 402 (1948) (a derivative action alleging mismanagement of the corporation, including failure to file an annual report, lack of notice of annual meeting, accumulating excess income without distribution to the members, deducting without authorization a small fee from milk sold through the co-op, and paying a fee, allegedly an unnecessary expense, to a corporation in which defendant was beneficially situated).

¹⁵The application for appointment of a receiver must allege one or more statutory grounds for the relief. IND. CODE § 34-1-12-1 (1976) sets forth seven general conditions which will justify the appointment of a receiver:

Sec. 1. A receiver may be appointed by the court, or the judge thereof in vacation, in the following cases:

First. In an action by a vendor to vacate a fraudulent purchase of property, or by a creditor to subject any property or fund to his claim.

Second. In actions between partners, or persons jointly interested in any property or fund.

Third. In all actions when it is shown that the property, fund or rent, and profits in controversy, is in danger of being lost, removed or materially injured.

Fourth. In actions by a mortgagee for the foreclosure of a mortgage, and

action¹⁶ and envisions the adverse party's possession of property which, for various reasons, requires protection.¹⁷ Additionally, the plaintiff must establish that he has an interest in the property which is the subject matter of the lawsuit;¹⁸ hence the appointment of a receiver is an *in rem* proceeding.¹⁹

the sale of the mortgaged property, when it appears that such property is in danger of being lost, removed or materially injured; or when such property is not sufficient to discharge the mortgaged debt, to secure the application of the rents and profits accruing before a sale can be had.

Fifth. When a corporation has been dissolved, or is insolvent, or is in imminent danger of insolvency, or has forfeited its corporate rights.

Sixth. To protect or preserve, during the time allowed for redemption, any real estate or interest therein sold on execution or order of sale, and to secure to the person entitled thereto the rents and profits thereof.

Seventh. And in such other cases as may be provided by law; or where, in the discretion of the court, or the judge thereof in vacation, it may be necessary to secure ample justice to the parties.

¹⁶Indianapolis Dairymen's Co-op. v. Bottema, 226 Ind. 237, 243, 79 N.E.2d 399, 403 (1948); State *ex rel.* Busick v. Ewing, 230 Ind. 188, 190, 102 N.E.2d 370, 371 (1951). In *Ewing*, the court held:

The petition for the appointment of receiver was filed as a separate action, and the appointment of a receiver was the sole relief therein sought by the plaintiffs. This case comes within the general rule that proceedings for the appointment of a receiver are ancillary in their nature and must be supported by a principal action. To confer jurisdiction upon the court in this case, it is therefore necessary that a principal action be filed to which the receivership is ancillary.

230 Ind. at 189-90, 102 N.E.2d at 371 (citations omitted). *But see* Supreme Sitting of the Order of the Iron Hall v. Baker, 134 Ind. 293, 305, 33 N.E. 1128, 1131 (1893).

¹⁷See notes 126-33 *infra* and accompanying text.

¹⁸According to the court in Steele v. Aspy, 128 Ind. 367, 27 N.E. 739 (1891):

To authorize the interposition of the court by the appointment of a receiver, it was essential that the appellee should show either a clear legal right in himself to the property in controversy, or that he had some lien upon or property right in it, or that it constituted a special fund out of which he was entitled to satisfaction of his demand. It was essential, to authorize the exercise of such jurisdiction, for the appellee to show that he had a present, existing interest in the property.

128 Ind. at 368, 27 N.E. at 740. *See also* State *ex rel.* Busick v. Ewing, 230 Ind. 188, 191, 102 N.E.2d 370, 372 (1951).

¹⁹See Hellebush v. Blake, 119 Ind. 349, 350, 21 N.E. 976, 977 (1889); Michigan Trust Co. v. Probasco, 29 Ind. App. 109, 114-15, 63 N.E. 255, 257 (1902). According to the court in *Hellebush*:

We are satisfied that the circuit court did have authority to appoint the receiver, notwithstanding the fact that the defendant was not a resident of this State. The property of which the court was asked to take possession through its receiver was within its jurisdiction, and it had authority to preserve and dispose of the property, through the medium of a receiver, in order to prevent its loss or destruction.

119 Ind. at 350-51, 21 N.E. at 977.

The application for the receiver may be for the appointment of a receiver pendente lite,²⁰ in which case it may either be with or without notice, or for the appointment upon the final adjudication of the issues before the court, in which case notice is not at issue, for there has already been a full adjudication of the rights of the parties. If the applicant seeks appointment pendente lite with notice, the statute provides that a receiver "shall not be appointed . . . until the adverse party shall have appeared; or shall have had reasonable notice of the application for such appointment"²¹ At the hearing on the application, the applicant must show that he will very probably prevail on the merits in the main action against the defendant.²² The defendant then has the opportunity to refute plaintiff's allegations but is not required to put forth any evidence since the burden of proof is upon the plaintiff.²³ If the plaintiff sustains his burden, then the court will appoint a receiver.

III. NATURE OF THE PROBLEMS ASSOCIATED WITH APPOINTMENT WITHOUT NOTICE

The problems associated with the appointment of a receiver without notice arise because some cases mandate this type of extraordinary relief for the full protection of a moving party's rights, and the statute provides for appointment without notice, yet the

²⁰"Pending the suit; during the actual progress of a suit; during litigation." BLACK'S LAW DICTIONARY 1290 (rev. 4th ed. 1968).

²¹IND. CODE § 34-1-12-9 (1976). Another problem which arises under the statute is that it does not define "reasonable notice"; Indiana courts have taken varying views on this issue.

²²See, e.g., Indianapolis Dairymen's Co-op. v. Bottema, 226 Ind. 237, 243, 79 N.E.2d 399, 403 (1948); Hawkins v. Aldridge, 211 Ind. 332, 338, 7 N.E.2d 34, 37 (1937). But cf. American Reclamation & Ref. Co. v. Klatte, 256 Ind. 566, 573, 270 N.E.2d 872, 876 (1971); Powell v. Powell, 160 Ind. App. 132, 134, 310 N.E.2d 898, 901 (1974) (Both cases involve the granting of a temporary restraining order without notice.). In *Klatte*, the court held that it was not necessary for the moving party to make a case which would ultimately prevail at the final hearing, "but only that there be shown a set of facts sufficient to justify further investigation by a court of equity." 256 Ind. at 573, 270 N.E.2d at 876.

²³Indianapolis Dairymen's Co-op. v. Bottema, 226 Ind. 237, 245, 79 N.E.2d 399, 404 (1948); Stair v. Meissel, 207 Ind. 280, 286, 192 N.E. 453, 455-56 (1934). According to the court in *Indianapolis Dairymen's Co-op.*:

Nor does an application for the appointment of a receiver relieve the plaintiff of the burden of proof on that issue. The defendant is not placed in a position where it must appear and show cause why a receiver should not be appointed, for this would be relieving the plaintiff of the burden of proof. In this case the burden of proof is upon the plaintiff to prove by a fair preponderance of the evidence that a receiver should be appointed under the equitable rules in such cases.

226 Ind. at 245, 79 N.E.2d at 404 (citations omitted).

United States Constitution demands due process of law.²⁴ Furthermore, the moving party faces grave repercussions if the court countmands the appointment.²⁵ Indiana courts, caught between these competing considerations, must weigh the need for protection of the complaining party's property interest against the constitutional rights of the party in possession of the property, the *prima facie* owner.²⁶

A. The Need For Extraordinary Relief

At times, situations have arisen which have required the extraordinary relief that only the appointment of a receiver without notice can provide.

The court in *Interstate Refineries, Inc. v. Barry*²⁷ affirmed the appointment of a receiver without notice where a corporation organized in Delaware operated oil refineries, oil fields, and gasoline stations in states other than Delaware. The corporation, heavily in debt, organized a corporation in Virginia with a name very similar to that of the Delaware corporation and began secretly transferring the assets of the Delaware corporation to the Virginia corporation for the purpose of escaping the claims of the shareholders and creditors. In addition to the fraudulent transfer of assets, the Delaware corporation neglected the management of its refineries, oil fields, and service stations. The creditors and shareholders, upon discovering defendant's actions, filed suit asking for injunctive relief and immediately petitioned for the appointment of a receiver without notice. The plaintiffs had to act expeditiously, lest the assets be put beyond their reach and the business be allowed to drift further into debt. Only the immediate appointment of a receiver without notice would protect such interests.²⁸

²⁴U.S. CONST. amend. XIV, § 1 provides:

No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

²⁵See notes 53-55 *infra* and accompanying text.

²⁶Albert Johann & Sons Co. v. Berges, 238 Ind. 265, 267, 150 N.E.2d 568, 569 (1958); Hawkins v. Aldridge, 211 Ind. 332, 343, 7 N.E.2d 34, 39 (1937). The court in *Albert Johann & Sons*, 238 Ind. at 267, 150 N.E.2d at 569, stating a reoccurring theme, held, in part: "[T]he appointment of a receiver *ex parte* and without notice to take over one's property or property which is *prima facie* his is one of the most drastic actions known to law or equity; . . . it should be exercised with extreme caution . . ." 45 Am. Jur. Receivers §90, p. 81 [(1943)]."

²⁷7 F.2d 548 (8th Cir. 1925).

²⁸The court of appeals recognized the urgency of the situation: "[I]mmediate action is imperative to preserve the property of the corporation and protect the stockholders from irremediable loss." *Id.* at 552 (citations omitted).

In *H-A Circus Operating Corp. v. Silberstein*,²⁹ a Missouri court had appointed a receiver over the assets of a circus corporation and authorized the appointment of an ancillary receiver in Indiana. The creditors came to Indiana and petitioned the Indiana court for the appointment of a receiver without notice on the grounds, *inter alia*, that the circus property was presently in Indiana and readily movable. If the creditors had had to wait until notice was issued and a hearing was held, the circus would have had an opportunity to load the property and flee the state. The court, understanding the predicament, granted the application and appointed a receiver without notice to protect the property pending an adjudication of the rights of the parties.³⁰ The Indiana Supreme Court affirmed the appointment of the ancillary receiver without notice to protect the creditor's recovery from the great danger that the circus property might easily be moved and because the Missouri court had already made the determination that a receivership was proper.³¹

The possibility that the assets may be removed from the court's jurisdiction is not the only justification for a court to appoint a receiver without notice. An emergency situation arose under a different set of circumstances in *Meyering v. Petroleum Holdings, Inc.*³² The defendants, all residents of Michigan, owned half interest in four oil and gas leases in Indiana. The plaintiffs owned the other half interest. In seeking the appointment of a receiver without notice, plaintiffs alleged a number of specific facts which made the appointment of a receiver *ex parte* necessary: (1) Defendants owed them \$9,000 for expenses in developing the leases; (2) one of the leases would be forfeited within one week if a well was not drilled within that time; (3) without the monies owed by defendants, the plaintiffs did not have sufficient funds to proceed with the drilling; and (4) on another lease, a competitor's well on an adjoining piece of property was draining the oil and gas reserves from plaintiffs' and defendants' lease. If plaintiffs had to wait for the perfection of notice, irreparable and material injury would occur.³³ The court

²⁹215 Ind. 413, 19 N.E.2d 1013 (1939).

³⁰*Id.* at 417, 19 N.E.2d at 1014.

³¹*Id. Accord, Security Sav. & Loan Ass'n v. Moore*, 151 Ind. 174, 175, 50 N.E. 869, 870 (1898).

³²227 Ind. 313, 86 N.E.2d 78 (1949).

³³The court in *Rotan v. Cummins*, 236 Ind. 394, 140 N.E.2d 505 (1957), commenting upon *Meyering*, held, *inter alia*:

The adverse parties were non-residents and had no agents in this state upon whom notice or process could be served; service by publication would have required 51 days, and during that period the failure to drill the said wells would have resulted in substantial damage to the plaintiff. The inadequacy of an appointment with notice or of a restraining order in such circumstances is obvious.

Id. at 398-99, 140 N.E.2d at 506-07.

cautiously affirmed the ex parte appointment: "We approach a consideration of this case with full realization that upon very few occasions has this court affirmed the appointment of a receiver without notice."³⁴

Again the court looked to the property which was the subject matter of the proceeding in order to determine whether to affirm the appointment of a receiver without notice. However, unlike *Interstate Refineries* and *H-A Circus*, in which the fear expressed was that the assets were being placed beyond the court's jurisdiction, the danger involved in *Petroleum Holdings* was physical damage to the property itself. In both types of emergency situations, the court affirmed the appointment of a receiver without notice.

As long as there is the possibility that this type of extraordinary relief may be required, the remedy of appointment without notice of a receiver must remain available. Thus the problem: The statute provides for appointment of a receiver without notice,³⁵ and some fact situations mandate such relief; yet, as will be shown, serious constitutional questions arise if property which is *prima facie* that of the party in possession is taken without notice and hearing.³⁶

B. *The State Permits Appointment Of A Receiver Without Notice*

The statute provides as the general rule that a receiver may not be appointed until the adverse party has had an opportunity to be heard. Then, as an exception to the general rule, the statute additionally permits appointment without notice upon the showing of sufficient cause:³⁷ "Receivers shall not be appointed, either in term or vacation, in any case, until the adverse party shall have appeared, or shall have had reasonable notice of the application for such appointment, except upon sufficient cause shown by affidavit."³⁸

C. *The Constitutional Problem*

The seizure of another's property without notice or hearing is a textbook example of violation of due process of law. In the words of Chief Justice White:

That to condemn without a hearing is repugnant to the due process clause of the 14th Amendment needs nothing

³⁴227 Ind. at 321, 86 N.E.2d at 81.

³⁵IND. CODE § 34-1-12-9 (1976).

³⁶See cases cited in note 26 *supra*.

³⁷See *H-A Circus Operating Corp. v. Silberstein*, 215 Ind. at 415-16, 19 N.E.2d at 1014; *Hawkins v. Aldridge*, 211 Ind. at 343, 7 N.E.2d at 38-39.

³⁸IND. CODE § 34-1-12-9 (1976).

but statement. . . . And that a corporation not more than an individual is subject to being condemned without a hearing or may be subjected to judicial power in violation of the fundamental principles of due process as recognized in *Pennoyer v. Neff*³⁹

The fundamental principles to which Chief Justice White refers are: (1) Notice to the adverse party, and (2) hearing by a judicial tribunal before the matter is finally determined.⁴⁰

The due process violation involved in the appointment of a receiver without notice was precisely stated by the Indiana Supreme Court in *State ex rel. Makar v. St. Joseph County Circuit Court*:⁴¹ "The appointment of a receiver is an extraordinary equitable remedy. The action affects one of man's most cherished and sacred rights guaranteed by the United States Constitution—the right to be secure in his property. This right is fundamental to every society in which men are free."⁴² Notwithstanding the long history of the receivership remedy in Indiana, the legislature has not enacted guidelines to guarantee the constitutional rights of the parties involved and thus has left the courts on uncertain ground whenever the issue arises.

In comparison, the temporary restraining order is also an extraordinary equitable remedy⁴³ and poses a potential constitutional

³⁹Riverside & Dan River Cotton Mills v. Menefee, 237 U.S. 189, 193-94 (1915).

⁴⁰Accord, *Town of Walkerton v. New York, Chicago & St. Louis R.R.*, 215 Ind. 206, 214, 18 N.E.2d 799, 803 (1939); *State ex rel. Lebanon Discount Corp. v. Superior Court*, 195 Ind. 174, 180, 144 N.E. 747, 749 (1924); *Falendar v. Atkins*, 186 Ind. 455, 460, 114 N.E. 965, 967 (1917).

⁴¹242 Ind. 339, 179 N.E.2d 285 (1962).

⁴²*Id.* at 347, 179 N.E.2d at 289 (footnote omitted).

⁴³A temporary restraining order is a preliminary step to the granting of a permanent injunction, IND. R. TR. P. 65, and is granted to maintain the status quo until the final determination on the merits. *Powell v. Powell*, 160 Ind. App. 132, 134, 310 N.E.2d 898, 901 (1974); *State ex rel. American Reclamation & Ref. Co. v. Klatte*, 256 Ind. 566, 573, 270 N.E.2d 872, 875-76 (1971). As with the appointment of a receiver without notice, a temporary restraining order will only issue when extreme necessity demands it. The court in *Indianapolis Dairymen's Co-op. v. Bottema*, 226 Ind. 237, 79 N.E.2d 399 (1948), in comparing injunctive relief, of which a temporary restraining order is part, held:

The power of appointment is a delicate one, and to be exercised with great circumspection. Indeed, the courts have held repeatedly that the power to appoint a receiver should be exercised with great care and the utmost caution and only in case of an emergency, and in a clear case, or in a case of "extreme necessity," where it appears that the appointment is necessary either to prevent fraud or to save the property from injury or threatened loss, or destruction, and more especially is this true where the corporation is solvent, or the defendant corporation is a bank. *This is the rule with respect to injunctions; it applies a fortiori with respect to the appointment of a receiver.* *Id.* 245, 79 N.E.2d at 404 (emphasis added) (quoting 16 W. FLETCHER, CYCLOPEDIA OF

problem because of the taking of a person's property without prior notice, yet the Indiana rules of court specifically impose certain procedural requirements on the granting of a temporary restraining order in an effort to satisfy the constitutional demands of due process.⁴⁴ A further restriction is that "[n]o restraining order . . . shall issue except upon the giving of security by the applicant, in such sum as the court deems proper . . .".⁴⁵ Thus, the court will only grant a temporary restraining order, a less severe action than the appointment of a receiver,⁴⁶ for a limited period,⁴⁷ and only if the applicant has posted a bond to indemnify the adverse party in the event of a wrongful order.

The courts, on the other hand, when considering an application for the appointment of a receiver without notice, do not have legislation or court rules to aid in determining what procedure will be constitutionally sufficient.⁴⁸ The statute requires only that "sufficient cause" be shown before a court may dispense with the notice requirement but does not define the term.⁴⁹ There is no statutory requirement that the appointment be temporary until notice is given and a hearing held⁵⁰ or that the party seeking the appointment

THE LAW OF CORPORATIONS § 7697, at 90-93 (repl. ed. 1942)). Thus, both receivership and restraining order are issued for comparable reasons and both are considered "extraordinary remedies."

⁴⁴IND. R. TR. P. 65(B)(2) requires:

Every temporary restraining order granted without notice shall be indorsed with the date and hour of issuance; shall be filed forthwith in the clerk's office and entered of record; shall define the injury and state why it is irreparable and why the order was granted without notice, and shall expire by its terms within such time after entry, not to exceed ten [10] days . . .

⁴⁵IND. R. TR. P. 65(C).

⁴⁶A temporary restraining order merely preserves the status quo and prevents the adverse party from taking action as specified in the order. *E.g.*, Powell v. Powell, 160 Ind. App. at 134, 310 N.E.2d at 901. A receiver, on the other hand, dispossesses the adverse party from the property which is the subject matter of the action and in some cases assumes control of the business and the day-to-day operations. See Lafayette Realty Corp. v. Moller, 247 Ind. 433, 438, 215 N.E.2d 859, 861 (1966).

⁴⁷IND. R. TR. P. 65(B) provides that the effective period is 10 days unless within the time so fixed the order, for good cause shown, is extended for a like period or unless the whereabouts of the party against whom the order is granted is unknown and cannot be determined by reasonable diligence or unless the party against whom the order is directed consents that it may be extended for a longer period.

⁴⁸The last clause of IND. CODE § 34-1-12-9 (1976) is the only statutory authority for the appointment of a receiver without notice. *State ex rel. Makar v. St. Joseph County Circuit Court*, 242 Ind. at 347, 179 N.E.2d at 289-90.

⁴⁹For appointment of a receiver, notice must first be given except upon sufficient cause shown by affidavit. IND. CODE § 34-1-12-9 (1976).

⁵⁰In *Stair v. Meissel*, 207 Ind. 280, 192 N.E. 453 (1934) (the appointment of a receiver without notice affirmed), the court held: "Our statute does not require that an

before notice post bond to indemnify the adverse party in the event of a wrongful appointment.⁵¹ Despite the lack of legislative assistance, and because the appointment of a receiver without notice necessarily involves the taking of one's property contrary to the fundamental elements of due process,⁵² the due process rights of the adverse party must in some way be safeguarded. Therefore, the Indiana courts have adopted strict substantive and procedural requirements designed to protect the constitutional rights of the adverse party. However, before addressing the question of how Indiana courts have attempted to protect the constitutional rights of the dispossessed party, there is one other practical problem which confronts a party petitioning the court for the appointment of a receiver without notice. Severe repercussions may result from the wrongful appointment of a receiver. Apart from the possible constitutional violations involved in the depriving of a person of his property without notice and hearing, the party moving for the ex parte receivership faces potential personal liability if the appointment should later be found to be erroneous. From the perspective of the practitioner, these repercussions are a more important consideration than the possible constitutional deprivations of the adverse party. For this reason, in order to fully appreciate what the courts have done in shaping a workable rule as well as the shortcomings of the rule which had developed, one must consider the possible negative consequences of the wrongful appointment.

appointment of a receiver made without notice shall be temporary and continue only until hearing held pursuant to notice; nor is there any statutory provision for either setting the appointment aside or confirming it." *Id.* at 284, 192 N.E. at 455. *But cf.* Indianapolis Mach. Co. v. Curd, 247 Ind. 657, 661, 221 N.E.2d 340, 342-43 (1966) (notwithstanding the absence of legislative authority, the court held: "[I]t unquestionably is error for a trial court to appoint a receiver without notice and fix no time whatever for a prompt notice and hearing.").

⁵¹Fagan v. Clark, 238 Ind. 22, 27, 148 N.E.2d 407, 409 (1958). The court, in comparing the remedy of receivership ex parte to relief by injunction or temporary restraining order held:

Relief by receivership is an extraordinary remedy and is never exercised if there is an adequate remedy at law or the harm can be prevented by injunction or restraining order. In the latter instance a bond affords some protection against an improvident order made for such equitable relief. However, in the case of a receivership, the statute does not provide for any bond indemnifying the injured party in case of an erroneous appointment of a receiver. Because of the radical nature of the remedy through receivership, this court does not look with favor upon an appointment without notice.

Id. at 26-27, 148 N.E.2d at 409 (citations omitted).

⁵²As stated, due process requires notice and hearing before taking a person's property. Yet where a receiver is appointed without notice, the party in possession is dispossessed of his property without either notice or hearing.

D. Repercussions from the Wrongful Appointment of a Receiver Without Notice

Because liability for the wrongful appointment without notice of a receiver usually depends upon the particular fact situation, the discussion which follows suggests generally what a moving party may face if later it is found that he was not entitled to the receivership and that the adverse party was wrongfully dispossessed of its property.

Damage for the wrongful appointment of an ex parte receivership may include damages for: (1) The expenses attributable to the appointment, maintenance, and termination of the receivership,⁵³ (2) abuse of process and malicious prosecution,⁵⁴ and (3) defamation of personal character and business reputation.⁵⁵ Additionally, exemplary damages may be awarded in some cases.⁵⁶

If a receiver is wrongfully appointed, the moving party can be made to bear the costs of the receiver as well as expenses associated with the adverse party's reversal of the order appointing the receiver.⁵⁷ Furthermore, such expenses may not be charged against the fund of which the receiver has possession.⁵⁸ Thus, the

⁵³O'Malley v. Hankins, 209 Ind. 461, 463, 199 N.E. 558, 559 (1936); Brock v. Rudig, 69 Ind. App. 190, 196, 119 N.E. 491, 492 (1918); Noxon Chem. Prods. Co. v. Leckie, 39 F.2d 318, 321 (3d Cir. 1930).

⁵⁴65 AM. JUR. 2d *Receivers* § 132 (1972).

⁵⁵Cf. Perry v. Columbia Broadcasting Sys., Inc., 499 F.2d 797, 800 (7th Cir. 1974) (Although the court was not faced with a receivership issue, theoretically the same principles may apply to the wrongful appointment of a receiver.).

⁵⁶Cf. Mowes v. Robbins, 68 Ind. App. 82, 86, 20 N.E. 51, 52 (1918); Citizens' St. R.R. v. Willoeby, 134 Ind. 563, 569, 33 N.E. 627, 629 (1893) (Neither case involves receiverships, yet the rules stated in each might be applicable to the wrongful appointment of a receiver.).

⁵⁷O'Malley v. Hankins, 209 Ind. 461, 463, 199 N.E. 558, 559 (1936); Noxon Chem. Prods. Co. v. Leckie, 39 F.2d 318, 321 (3d Cir. 1930).

⁵⁸The court in O'Malley v. Hankins, 209 Ind. 461, 199 N.E. 558 (1936), a leading Indiana case on this subject, unequivocally held:

It cannot be questioned that, when a judgment appointing a receiver is reversed on appeal and vacated upon the ground that there were insufficient facts established to justify the appointment, neither the defendant nor the property for which the receiver was appointed can be charged for the services of the receiver, or the receiver's attorneys, or the plaintiff's attorneys.

Id. at 463, 199 N.E. at 559. Similarly, the court in Noxon Chem. Prods. Co. v. Leckie, 39 F.2d 318 (3d Cir. 1930), held:

All such compensation, to which the several parties might be entitled, must be taxed against the plaintiff, whose proceeding it was, and upon whom the blame for the wrong committed must legally rest. When the court is without jurisdiction, the cases are unanimous in holding that the court is without power to make any charge upon the assets or expenses for compensation.

Id. at 321.

moving party, in addition to being saddled with his own expenses in pursuing the appointment of the receiver, must also bear the costs of a receiver's compensation for services rendered, the receiver's attorney fees, and the adverse party's attorney fees associated with the vacation of the appointment.

Additionally, the wrongful appointment of a receiver without notice may subject the moving party to damages for malicious prosecution or abuse of process.⁵⁹ An action for malicious prosecution will lie if the adverse party can establish: (1) The defendant instituted the prosecution, (2) the defendant acted maliciously and without probable cause, and (3) the prosecution terminated in the plaintiff's favor.⁶⁰ An action for abuse of process, on the other hand, lies for the improper use of process after it has been issued and not for maliciously causing the process to issue.⁶¹ Thus, if the moving party maliciously caused process to issue and the appointment to proceed or if it improperly used the process and appointment after issuance, the moving party may be liable for these additional elements of damages.

Also the appointment ex parte of a receiver may subject the moving party to damages arising out of a defamation action. The appointment of a receiver may cause disastrous consequences to a person's individual esteem and his business reputation. Generally,

⁵⁹Cf. *Cassidy v. Cain*, 145 Ind. App. 581, 587-88, 251 N.E.2d 852, 856 (1969); *Boyd v. Hodson*, 117 Ind. App. 296, 301, 72 N.E.2d 46, 48 (1947) (neither *Cassidy* nor *Boyd* involved the appointment of a receiver, yet the rule laid down in each conceivably could be applied to a wrongful receivership).

⁶⁰E.g., *Cassidy v. Cain*, 145 Ind. App. 581, 587-88, 251 N.E.2d 852, 856 (1969).

⁶¹*Brown v. Robertson*, 120 Ind. App. 434, 437, 92 N.E.2d 856, 857-58 (1950). The court in *Robertson* compared a cause of action for malicious prosecution with that of abuse of process:

"The distinctive nature of an action for abuse of process, as compared with an action for malicious prosecution, is that the former lies for the improper use of process after it has been issued, not for maliciously causing process to issue. Where the matter complained of concerns the issuance of process, the action is either strictly or by analogy one for malicious prosecution. In this category are included actions for the malicious institution of criminal proceedings, the wrongful and malicious procurement of attachment or other process of seizure, and the institution of bankruptcy proceedings. In such cases it is, for obvious reasons, generally held that want of probable cause and the existence of malice in procuring the issuance of the process, as well as a termination favorable to the plaintiff, are essential to the maintenance of the action. But where the thing complained of is not that issuance of the process was wrongfully procured, but that, having been issued, it was willfully perverted, so as to accomplish a result not commanded by it or lawfully obtainable under it, the action has been denominated by well-considered cases as one for the abuse of process." 1 Am. Jur., Abuse of Process, § 3, p. 176.

Id. at 437-38, 92 N.E.2d at 858.

"[u]nder Indiana law . . . a statement may be defamatory when it is such as would tend to hold the plaintiff up to hatred, contempt, or ridicule, or when it causes him to be shunned or avoided or tends to injure him in his profession, trade, or calling."⁶² Given the proper set of circumstances, an aggrieved party may be able to make a case for defamation arising from the wrongful appointment of a receiver.

Finally, if the moving party sought the appointment fraudulently,⁶³ or with malice or in heedless disregard of the consequences,⁶⁴ then it may also be subject to exemplary damages.

These possible repercussions to the moving party should cause a person to carefully consider whether or not its predicament demands such an extraordinary remedy.

IV. HOW INDIANA COURTS GUARANTEE DUE PROCESS

A. General Approach

Despite the seemingly inherent violation of due process involved in the taking of another's property without notice or hearing, the Indiana courts, in strictly construing the statute and in rigidly applying to the facts of each case the standard which has evolved over the years for appointing a receiver without notice, have sought to safeguard the rights of both the party in possession of the property and the one seeking possession of it.

An adverse party's rights are protected in two ways: (1) The statute only permits appointment without notice in exceptional cases;⁶⁵ and (2) the courts strictly construe the statute.⁶⁶ This dual

⁶²Perry v. Columbia Broadcasting Sys., Inc., 499 F.2d 799, 800 (7th Cir. 1974). Additionally, according to the court in Prosser v. Callis, 117 Ind. 105, 19 N.E. 735 (1889):

The words need not necessarily impute disgraceful conduct to the plaintiff; it is sufficient if they render him contemptible or ridiculous. Any written words are defamatory which impute to the plaintiff that he has been guilty of any crime, fraud, dishonesty, immorality, vice, or dishonorable conduct, or has been accused or suspected of any such misconduct, or which suggest that the plaintiff is suffering from any infectious disorder, or which have a tendency to injure him in his office, profession, calling, or trade; and so, too, are all words which hold the plaintiff up to contempt, hatred, scorn, or ridicule, and which, by thus engendering an evil opinion of him in the minds of right-thinking men, tend to deprive him of friendly intercourse and society.

Id. at 107-08, 19 N.E. at 736.

⁶³Cf. Mowes v. Robbins, 68 Ind. App. 82, 86, 120 N.E. 51, 52 (1918) (does not involve the appointment of a receiver, but does state a rule which might find application in the wrongful appointment of a receiver).

⁶⁴Cf. Citizens' St. R.R. v. Willoeby, 134 Ind. 563, 569, 33 N.E. 627, 629 (1893) (does not involve the wrongful appointment of a receiver, but does state a rule which could easily be applied to the receivership situation given the proper circumstances).

⁶⁵Henderson v. Reynolds, 168 Ind. 522, 527, 81 N.E. 494, 496 (1907).

⁶⁶Fagan v. Clark, 238 Ind. 22, 26, 148 N.E.2d 407, 409 (1958); State *ex rel.* Makar v. St. Joseph County Circuit Court, 242 Ind. 339, 347, 179 N.E.2d 285, 289-90 (1961).

safeguard is actually a two-tiered protection rather than two independent methods by which the adverse party's rights are protected. The significance of the two-tiered standard is that it generally is more difficult to satisfy a second higher level requirement than a second requirement of the same degree as the first. The courts are empowered to act by virtue of the statute which permits appointment without notice only in exceptional cases⁶⁷ and then the courts, in construing what constitutes an "exceptional case," strictly interpret those words.⁶⁸ Thus, as will be shown, the appointment of a receiver without notice will not often occur.⁶⁹

The Indiana statute⁷⁰ sets forth as the general rule that the adverse party must have notice and an opportunity to be heard before the court will appoint a receiver. Appointment without notice is the exception to the general rule.⁷¹ Thus, the first level of protection is that a party petitioning for the appointment of a receiver without notice must demonstrate to the court that the exception rather than the general rule should apply.⁷²

⁶⁷IND. CODE § 34-1-12-9 (1976).

⁶⁸See *Henderson v. Reynolds*, 168 Ind. 522, 527, 81 N.E. 494, 496 (1907).

⁶⁹There have been very few Indiana cases in which the appointment of a receiver without notice has been sustained on appeal. *Meyering v. Petroleum Holdings, Inc.*, 227 Ind. 313, 86 N.E.2d 78 (1949); *H-A Circus Operating Corp. v. Silberstein*, 215 Ind. 413, 19 N.E.2d 1013 (1939); *Stair v. Meissel*, 207 Ind. 280, 192 N.E. 453 (1934).

⁷⁰IND. CODE § 34-1-12-9 (1976).

⁷¹The court in *Henderson* held: "When such notice can be given it should be given, unless there is imminent danger of loss, or great damage, or irrevocable injury, or the greatest emergency, or when by the giving of notice the very purpose of the appointment of a receiver would be rendered nugatory" 168 Ind. at 527-28, 81 N.E. at 496 (quoting *North Am. Land & Timber Co. v. Watkins*, 109 F. 101, 106 (8th Cir. 1901)).

⁷²See *Inter-City Contractors Serv., Inc. v. Jolley*, 257 Ind. 593, 595, 277 N.E.2d 158, 160 (1972); *Indianapolis Mach. Co. v. Curd*, 247 Ind. 657, 662, 221 N.E.2d 340, 343 (1966); *Albert Johann & Sons Co. v. Berges*, 238 Ind. 265, 267, 150 N.E.2d 568, 569-70 (1957); *Environmental Control Sys., Inc. v. Allison*, 314 N.E.2d 820, 824 (Ind. Ct. App. 1974).

As a prelude to the discussion which follows, consider what the court in *Henderson* held to be "exceptional cases":

The exceptional cases are when the defendant is beyond the jurisdiction of the court, or cannot be found, or when some emergency is shown rendering interference, before there is time to give notice, necessary to prevent waste, destruction or loss; or when notice itself will jeopardize the delivery of the property, over which the receivership is extended in obedience to the order of the court. It must be a case of imperious necessity, requiring immediate action, and where protection cannot be afforded the plaintiff in any other way.

168 Ind. at 527, 81 N.E. at 496 (citations omitted). The *Henderson* holding sets forth in a broad way the guidelines which courts should follow when considering such a case, but does not specifically define what must be shown or the degree of certainty required of such a showing. Neither does the statute aid in determining what is suffi-

The second level of the two-tiered approach is that courts are reluctant to exercise their statutory power.⁷³ The basis for this reluctance is that the courts are eminently aware of the constitutional problems⁷⁴ involved in the taking of a person's property,⁷⁵ especially in the case of a receiver without notice where the receiver takes the property without forewarning. The court in *Fagan v. Clark*⁷⁶ summarized well the attitude of Indiana courts:

[W]e are not inclined to extend or broaden the privileges of one who asks for a receiver without notice. On the other hand, we are inclined to throw all the protection possible around the aggrieved party who had been deprived of his property by an ex parte hearing and without notice.⁷⁷

Therefore, the courts in strictly construing what is required to elevate a case to that of an "exceptional" case, provide further protection for the adverse party's rights.

B. The Development of Indiana Case Law—The Johann Rule

Indiana courts have attempted to relieve the tension created by the competing considerations of the constitutional guarantee of due process and the property interests of the party seeking the appoint-

cient cause to support the appointment of a receiver without notice. *Wabash Ry. v. Dykeman*, 133 Ind. 56, 32 N.E. 823 (1892).

⁷³An indication of this reluctance is the general theme with which many courts preface their opinions—receivership without notice is an extraordinary remedy. The use of this language demonstrates their hesitancy to invoke such measures. By definition an "extraordinary" remedy is one not commonly employed. BLACK'S LAW DICTIONARY 699 (rev. 4th ed. 1968). Furthermore, only on rare occasions have Indiana courts affirmed the appointment of a receiver without notice, evidencing this reluctance. See *H-A Circus Operating Corp. v. Silberstein*, 215 Ind. 413, 416, 19 N.E.2d 1013, 1014 (1939). See also *Lafayette Realty Corp. v. Moller*, 247 Ind. 433, 438-39, 215 N.E.2d 859, 861 (1966); *Fagan v. Clark*, 238 Ind. 22, 26, 148 N.E.2d 407, 409 (1958); *Henderson v. Reynolds*, 168 Ind. 522, 527, 81 N.E. 494, 496 (1907); *Wabash Ry. v. Dykeman*, 133 Ind. 56, 65, 32 N.E. 823, 826 (1892); *Environmental Control Sys., Inc. v. Allison*, 161 Ind. App. 148, 153, 314 N.E.2d 820, 823 (1974).

⁷⁴See *State ex rel. Red Dragon Diner, Inc. v. Superior Court*, 239 Ind. 384, 158 N.E.2d 164 (1959), wherein the court held:

Notice, giving a defendant opportunity to be informed regarding the nature of the action and reasonable opportunity to make a defense, is an essential element of due process. Our statutes which specifically limit the authority of the court to appoint receivers without notice is in implementation of the above constitutional guarantee.

Id. at 385-86, 158 N.E.2d at 165 (footnotes omitted).

⁷⁵See, e.g., *Jones v. Becker*, 212 Ind. 248, 254, 8 N.E.2d 587, 590 (1937); *Kent Ave. Grocery Co. v. George Hitz & Co.*, 187 Ind. 606, 608, 120 N.E. 659, 660 (1918).

⁷⁶238 Ind. 22, 148 N.E.2d 407 (1958).

⁷⁷*Id.* at 31, 148 N.E.2d at 412.

ment of a receiver without notice. Although one praying for the extraordinary relief must overcome rather formidable obstacles, a general disfavor and reluctance on the part of the courts to employ their statutory authority, as well as a great amount of precedent to support the courts' denial of the remedy,⁷⁸ factual situations have arisen in the past and no doubt will arise in the future which mandate appointment without notice. The discussion which follows precisely details the evolution of the elements of proof which the party petitioning for appointment without notice will have to satisfy in order to compel a generally unsympathetic court to grant a motion for receivership without notice. The analysis not only will aid a practicing attorney, but more importantly, the analysis will also indicate how the requirements announced by the courts provide a great degree of protection for an unwitting party in possession.

As previously demonstrated, Indiana courts have consistently hesitated to grant a motion for the ex parte appointment of a receiver; not until the Indiana Supreme Court handed down its decision in *Albert Johann & Sons Co. v. Berges*,⁷⁹ however, did the court explicitly indicate what a party petitioning for appointment without notice must establish.⁸⁰

The *Johann* rule is not particularly novel; the holding is significant, however, in that for the first time it was possible to analyze a court's holding in any particular case against an explicit standard, as well as to measure the standard itself against the constitutional re-

⁷⁸Fagan v. Clark, 238 Ind. 22, 148 N.E.2d 407 (1958); Rotan v. Cummins, 236 Ind. 394, 140 N.E.2d 505 (1957); Johann v. Johann, 232 Ind. 40, 111 N.E.2d 473 (1953); Second Real Estate Invs., Inc. v.-Johann, 232 Ind. 24, 111 N.E.2d 467 (1953). See note 83 *infra*.

⁷⁹238 Ind. 265, 150 N.E.2d 568 (1958).

⁸⁰The following have been established in Indiana as conditions precedent to the appointment of a receiver without notice:

1. The complaint must affirmatively show (a) a probability that plaintiff will be entitled to judgment; (b) that there not only is cause for the appointment of a receiver, but that there is sufficient cause for such appointment without notice; and (c) that plaintiff's rights cannot be protected by a restraining order or other adequate remedy, and if this is shown, then it must be further shown that the emergency necessitating the appointment could not have been anticipated in time to give notice or that waste or loss is threatened and delay until notice can be given will defeat the object of the suit.

2. The only evidence which is proper under § 3-2602 [IND. CODE § 34-1-12-1 (1976)] to be considered by the trial court must be in the form of affidavits, which may include or consist of the verified complaint.

3. The facts justifying the relief sought must be shown by the affidavits or verified complaint, and mere conclusions of a plaintiff will not suffice.

Id. at 268, 150 N.E.2d at 569-70 (footnotes omitted).

quirement of the fourteenth amendment of the United States Constitution.

The *Johann* rule consists of a substantive rule which sets forth the factual setting which must be present and the formal procedural requirements for an application for the appointment of a receiver without notice. The discussion which follows first considers the substantive aspects and then the procedural requirements.

The *Johann* holding is derived from a compilation of previous court holdings⁸¹ reversing the appointment of a receiver without notice. Prior to *Johann*, when the court reversed the appointment without notice, it generally focused on one or two reasons why the appointment in that particular case was not justified.⁸² Such procedure was proper since the plaintiff has the burden of proving every element of its case.⁸³ Thus, if the defendant convinced the court of any fallacy in plaintiff's reasoning then the court properly reversed the appointment.

Under the *Johann* rule, one element of proof that the plaintiff must demonstrate by a preponderance of the evidence is that it will ultimately prevail on the merits.⁸⁴ The rationale for this part of the rule should be obvious. The courts will only appoint a receiver when the situation clearly demands such relief⁸⁵ and justice between the

⁸¹See, e.g., Second Real Estate Invs. v. Johann, 232 Ind. 24, 31-32 n.3, 111 N.E.2d 467, 471 n.3 (1953) (quoting 1 R. CLARK, A TREATISE ON THE LAW AND PRACTICE OF RECEIVERS § 82, at 111-12 (2d ed. 1929)) (adopting a rule very similar to that as found in condition one of the *Johann* rule):

The statutes of Indiana provide specifically that a receiver can only be appointed without notice upon sufficient cause shown by affidavit. The Supreme Court of Indiana lays down three salutary rules governing such appointment. These rules are substantially covered by the statement of the author in the beginning of this section, nevertheless they will bear repetition as stated by the Indiana court as follows:

1. That the property is about to be wasted, destroyed or removed beyond the jurisdiction.
2. That the issuing of a temporary restraining order or other relief that may be obtained, will not protect the property until notice can be given.
3. That delay until notice can be given will defeat the object of the suit.

See also cases cited in note 78 *supra*.

⁸²E.g., Hawkins v. Aldridge, 211 Ind. 332, 343, 7 N.E.2d 34, 38 (1937) (stressing the availability of alternate remedies as the reason for reversing the ex parte appointment); Bookout v. Foreman, 198 Ind. 543, 546, 154 N.E. 387, 388 (1926) (reversing appointment because the moving party's failed to demonstrate an emergency situation).

⁸³The plaintiff has the burden of proving by a preponderance of the evidence that the appointment of a receiver is necessary. Indianapolis Dairymen's Co-op. v. Bottema, 226 Ind. 237, 245, 79 N.E.2d 399, 404 (1948). See generally note 23 *supra*.

⁸⁴See generally note 6 *supra*.

⁸⁵E.g., Hawkins v. Aldridge, 211 Ind. 332, 343, 7 N.E.2d 34, 38 (1937).

parties cannot be effectuated in any other way.⁸⁶ If the plaintiff cannot establish that he will ultimately prevail on the merits, the court will not put itself in the position of being reversed, and furthermore the court, in balancing the property interests of each party, will not order a receiver *pendente lite* to seize the property of the *prima facie* owner⁸⁷ only to return the property after the case is finally adjudicated.

Secondly, not only must the plaintiff establish that appointment of a receiver with notice is necessary, but also that there are sufficient grounds for dispensing with the need for notice.⁸⁸ The rationale for this part of the rule is also straight forward. The moving party must first satisfy all of the requirements for appointment *with* notice and then demonstrate that there exists some additional reason why notice cannot be given in the particular fact situation. The appointment without notice to the dispossessed party is obviously a much more drastic action than the appointment of a receiver after the merits of the case have been fully adjudicated and after both parties have had an opportunity to present evidence and argue their cases. Therefore, an appointment without notice requires a higher degree of proof.

Another element of the plaintiff's case is a showing that the emergency giving rise to a prayer for appointment without notice cannot be forestalled until notice can be given and a hearing held by granting a temporary restraining order or other adequate relief.⁸⁹

⁸⁶See, e.g., *Hawkins v. Aldridge*, 211 Ind. 332, 341, 7 N.E.2d 34, 38 (1937); *Bookout v. Foreman*, 198 Ind. 543, 547, 154 N.E. 387, 388 (1926); *Goshen Woolen Mills Co. v. City Nat'l Bank*, 150 Ind. 279, 286, 49 N.E. 154, 156 (1898). Theoretically, appointment of a receiver occurs only when there is no other "full and adequate remedy." Thus, if any alternate remedies to the appointment of a receiver are applicable to a particular fact situation, not only should they be used, but they must be used. *Henderson v. Reynolds*, 168 Ind. 522, 527, 81 N.E. 494, 496 (1907).

⁸⁷See note 26 *supra*.

⁸⁸*Hampton v. Massey*, 215 Ind. 247, 248, 19 N.E.2d 464, 465 (1939); *Ledger Publishing Co. v. Scott*, 193 Ind. 683, 685-86, 141 N.E. 609, 609 (1923). The court in *Ledger Publishing Co.* held:

To justify the appointment of a receiver without notice, not only must one of the statutory causes for the appointment exist, but *each* of the following conditions must be shown, namely, that the property is about to be wasted or removed beyond the jurisdiction of the court; that delay *until notice can be given* will defeat the object of the suit; that the issuing of a temporary restraining order, or other relief that may be obtained, will not protect the property until notice can be given.

193 Ind. at 685-86, 141 N.E. at 609.

⁸⁹*Hawkins v. Aldridge*, 211 Ind. 332, 343, 7 N.E.2d 34, 39 (1937); *Bookout v. Foreman*, 198 Ind. 543, 546-47, 154 N.E. 387, 388 (1926); *Tucker v. Tucker*, 194 Ind. 108, 111-12, 142 N.E. 11, 13 (1924).

Unless notice will defeat the object of the suit, it must be given.⁹⁰ The United States Court of Appeals for the Fifth Circuit held in *Cabanissa v. Reco Mining Co.*⁹¹ "When such notice can be given it should be given"⁹² The countervailing circumstances which cause the giving of notice to be impractical are at the very heart of this Note. This rule announced by *Johann* is an attempt to outline, with the greatest specificity, what the moving party must present to a court in order to entitle him to the appointment of a receiver without notice.

The courts are most sensitive to a situation in which the appointment of a receiver without notice is absolutely required to maintain the status quo until notice can be given. Even where the facts appear compelling and the wrongdoing by the party in possession is blatant, a court will not necessarily grant the petition appointment of a receiver without notice. The circumstances which precipitated the suit in *Johann* are a typical situation in which the facts seem compelling, yet upon close scrutiny the court determined that an ex parte receivership would not be proper. In *Johann* the plaintiff in its verified complaint cited specific acts of impropriety committed by the corporation's president, including the purchase of a \$6,500 speed boat with corporate funds,⁹³ the pledge of corporate stock to secure a personal debt, the doubling of accounts payable during a period when the case account fell by fifty percent, as well as the imminent danger of insolvency⁹⁴ which plagued the corporation. Notwithstanding this seemingly compelling set of circumstances, the supreme court reversed the trial court's appointment of a receiver without notice. The court held that the petition failed to demonstrate an emergency which would cause the appointment of a receiver without notice to be the only remedy whereby justice between the parties could be served.⁹⁵

Another element of the *Johann* rule is that the emergency which the petitioner claims exists must not have been reasonably foreseeable: "It is well settled that a party seeking injunction or the appointment of a receiver cannot by his own delay or failure to act promptly create an emergency which will excuse his giving the re-

⁹⁰*Henderson v. Reynolds*, 168 Ind. 522, 527, 81 N.E. 494, 496 (1907) (citing *Cabanissa v. Reco Mining Co.*, 116 F. 318, 323-24 (5th Cir. 1902)); *Chicago & South-eastern Ry. v. Cason*, 133 Ind. 49, 51, 32 N.E. 827, 828 (1892).

⁹¹116 F. 318 (5th Cir. 1902).

⁹²*Id.* at 324.

⁹³The Albert Johann & Sons Corporation was in the business of directing funerals.

⁹⁴Imminent danger of insolvency is a statutory ground for the appointment of a receiver. IND. CODE § 34-1-12-1(5) (1976).

⁹⁵238 Ind. at 270, 150 N.E.2d at 570.

quired notice to the adverse party.”⁹⁶ Again, the rationale for such a rule is not difficult to understand. To hold otherwise would function as a disincentive for attorneys to explore alternative means of relief. Furthermore, the courts of equity have long frowned upon granting relief to a party who has slumbered on his rights.

The final substantive showing required by *Johann* is that plaintiff's rights cannot be adequately protected by a temporary restraining order or other remedy.⁹⁷ Again, the *Johann* court merely stated what had been the rule for several years:⁹⁸ The courts simply will not appoint a receiver without notice except where it is absolutely necessary to do justice between the parties.⁹⁹ If alternate forms of relief are available and such relief is sufficient to safeguard the rights of the parties, then the court will deny the application for receiver without notice in favor of the alternative.¹⁰⁰

⁹⁶Henderson v. Reynolds, 168 Ind. 522, 529, 81 N.E. 494, 496 (1907).

⁹⁷238 Ind. at 267, 150 N.E.2d at 571. *See also* Ledger Publishing Co. v. Scott, 193 Ind. 683, 686, 141 N.E. 609, 609 (1923).

⁹⁸E.g., Hawkins v. Aldridge, 211 Ind. 332, 343, 7 N.E.2d 34, 38 (1937) (citing Kent Ave. Grocery Co. v. George Hitz & Co., 187 Ind. 606, 608-09, 120 N.E. 659, 660 (1918)): “[A] receiver will not be appointed without notice when a court, as in this state, has authority to grant a temporary restraining order without notice, and where the issuance of such an order would afford ample protection until notice can be given” Similarly, the court in *Henderson v. Reynolds*, 168 Ind. 522, 81 N.E. 494 (1907), held: “[A] receiver will not be appointed without notice when a court, as in this State, has the power to grant a temporary restraining order, without notice, and the same is ample to protect the property until notice is given and the application for a receiver heard and determined.” *Id.* at 527, 81 N.E. at 496.

⁹⁹See note 86 *supra* and accompanying text.

¹⁰⁰A temporary restraining order is the most often utilized alternate form of relief; *see generally* Bookout v. Foreman, 198 Ind. 543, 546, 154 N.E. 387, 388 (1926); Tucker v. Tucker, 194 Ind. 108, 111, 142 N.E. 11, 13 (1924). Other substitute remedies include attachment and garnishment; *see* Hawkins v. Aldridge, 211 Ind. 332, 342, 7 N.E.2d 34, 38 (1937). In *Hawkins* the court held:

Attachment is a remedy at law, available to one seeking a money judgment, where the defendant has threatened to cheat, hinder, or delay his creditors, or where he is intending to leave the state with intent to defraud his creditors. Attachment would have provided ample relief. But here, also, a bond is required to protect the defendant.

In *May v. Greenhill et al.* (1881) 80 Ind. 124, where the complaint was in many respects similar to the one under consideration, it was held that the plaintiff had a full, complete, and ample remedy by attachment or garnishment, and that a receiver should have been appointed

The statutory remedy of attachment is a legal remedy, available without notice, upon giving bond, which would furnish all of the protection that was here sought by a receivership. There is no bond to protect the defendants where a receiver is appointed. The principles here referred to have been long well settled and repeatedly announced by this court from the earliest times.

211 Ind. at 342, 7 N.E.2d at 38-39.

The reader should, however, note that there are repercussions from wrongful use of these remedies. *See Bick v. Long*, 15 Ind. App. 503, 505, 44 N.E. 555, 556 (1896).

The procedural aspects of the *Johann* rule as they relate to the form and sufficiency of the pleadings have also evolved from cases prior to *Johann*.¹⁰¹ Like the requisite substantive elements, the form and sufficiency of the pleadings reflect the court's awareness of the constitutional problems in the dispossession of an individual of property without notice and hearing. The discussion which follows considers the way in which the procedural elements of the rule attempt to guarantee the constitutional rights of the party in possession.

Condition two of the rule¹⁰² reflects the statutory mandate of "sufficient cause shown by affidavit" and requires that all evidence submitted to the court be in the form of affidavit or verified complaint.¹⁰³ Like the first condition of the rule, the second condition is not a unique interpretation, but rather a long held requirement of the procedure for obtaining the appointment of a receiver without notice.¹⁰⁴ The importance of this rule is two-fold. First, such procedure enables the supreme court to review the precise evidence upon which the trial court determined that the appointment without notice was proper.¹⁰⁵ The transcript of the trial court proceedings in and of itself is insufficient because in an ex parte proceeding the adverse party is not present to challenge the testimony of the moving party.¹⁰⁶ The courts therefore will only consider evidence in the form of verified complaints and affidavits based upon personal belief

¹⁰¹*E.g.*, Second Real Estate Invs., Inc. v. Johann, 232 Ind. 24, 29, 111 N.E.2d 467, 470 (1953); Hampton v. Massey, 215 Ind. 247, 248, 19 N.E.2d 464, 464 (1939); Hizer v. Hizer, 201 Ind. 406, 414, 169 N.E. 47, 50 (1929).

¹⁰²See note 80 *supra*.

¹⁰³IND. CODE § 34-1-12-9 (1976).

¹⁰⁴Mannos v. Bishop-Babcock-Becker Co., 181 Ind. 343, 104 N.E. 579 (1914), wherein the court explained:

This court, in actions at law, cannot weigh evidence, oral or written. . . . In equity causes, it will not determine where the preponderance lies in conflicting oral testimony. . . . But in such cases, where the evidence is wholly documentary or written, it weighs the evidence adduced. . . . The appointment of a receiver is purely of equitable cognizance.

Id. at 345-46, 104 N.E. at 580 (citations omitted).

Furthermore, according to the court in *Rotan v. Cummins*, 236 Ind. 394, 140 N.E.2d 505 (1957): "This court has never questioned or deviated from the proposition that a receiver without notice can not be appointed unless the moving party *shows by verified complaint or affidavit* that neither the ordinary procedure for appointment, which requires notice to be given . . ." *Id.* at 397, 140 N.E.2d at 506 (citations omitted) (emphasis added).

¹⁰⁵Appeals from the appointment of a receiver with or without notice are made directly to the Indiana Supreme Court. IND. CODE § 34-1-12-10 (1976).

¹⁰⁶See *Indiana Merchants' Protective Ass'n v. Little*, 202 Ind. 193, 195, 172 N.E. 905, 906 (1930); Mannos v. Bishop-Babcock-Becker Co., 181 Ind. 343, 345, 104 N.E. 579, 580 (1914).

as vehicles for introducing all of the relevant facts into evidence.¹⁰⁷ Thus, for the purpose of reviewing the propriety of a trial court's ruling, the exact facts which generated the decision must be preserved.

Aside from the interests of the supreme court in having a precise record for appeal, such a record serves the related purpose of informing the adverse party of the grounds for the confiscation of its property: "Thus the adverse party may know the exact facts upon which the judge acted in appointing a receiver in his absence and wresting from him the control of his property without a hearing or an opportunity for such hearing"¹⁰⁸ The courts place great emphasis on the form of the pleadings and will not relax the requirement of a verified complaint or affidavit.¹⁰⁹

The final element of the *Johann* rule is that the affidavits or verified complaint must be based on personal knowledge, in positive terms,¹¹⁰ and stated as facts rather than conclusions.¹¹¹ The unsupported statement that directors could commit certain wrongful acts has been held insufficient cause for dispensing with notice; instead a verified statement was required that the adverse party "had done or attempted or threatened to do" the wrongful acts.¹¹² Furthermore, the mere apprehension or fears of the moving party are insufficient

¹⁰⁷Second Real Estate Invs. v. Johann, 232 Ind. 24, 30, 111 N.E.2d 467, 470 (1953); Indiana Merchants' Protective Ass'n v. Little, 202 Ind. 193, 196, 172 N.E. 905, 906 (1930).

Additionally, according to the court in *Sullivan Elec. Light & Power Co. v. Blue*, 142 Ind. 407, 41 N.E. 805 (1895):

Without such facts being spread upon the record on appeal to a higher court from such an interlocutory order allowed by another section of the same statute, the appeal might prove to be fruitless and unavailing. So that we must look to the facts stated on paper, at the time the application . . . was made, exclusively to find the cause, if any there was, to justify the appointment without notice.

Id. at 417, 41 N.E. at 808.

¹⁰⁸*Environmental Control Syss., Inc. v. Allison*, 314 N.E.2d 820, 823 (Ind. Ct. App. 1974).

¹⁰⁹*Hizer v. Hizer*, 201 Ind. 406, 414, 169 N.E. 47, 50 (1929); *Environmental Control Syss., Inc. v. Allison*, 314 N.E.2d 820, 823 (Ind. Ct. App. 1974).

¹¹⁰*Ledger Publishing Co. v. Scott*, 193 Ind. 683, 685, 141 N.E. 609, 609 (1923); *Mannos v. Bishop-Babcock-Becker Co.*, 181 Ind. 343, 347, 104 N.E. 579, 580 (1914); *Henderson v. Reynolds*, 168 Ind. 522, 524, 81 N.E. 494, 495 (1907).

¹¹¹*Inter-City Contractors Serv., Inc. v. Jolley*, 257 Ind. 593, 277 N.E.2d 158 (1972); *Meek v. Steele*, 368 N.E.2d 257, 258 (Ind. Ct. App. 1977).

¹¹²*Welfare Loan Soc'y of Anderson v. Seward*, 193 Ind. 541, 542, 141 N.E. 221, 221 (1923). See also *Environmental Control Syss., Inc. v. Allison*, 314 N.E.2d 820 (Ind. Ct. App. 1974) (citing *Indianapolis Mach. v. Curd*, 247 Ind. 657, 664, 221 N.E.2d 340, 345 (1966)), wherein the court held:

Property may not be taken from persons acting as legally appointed trustees, arbitrarily and without notice, unless it is *clearly first shown by facts specifically alleged* (not conclusions) that they threaten to and that they plan

grounds for the appointment of a receiver without notice.¹¹³ An affidavit sworn "to the best of knowledge and belief" has uniformly been held inadequate.¹¹⁴ For the reasons which follow, the phraseology is too equivocal to safeguard the constitutional rights of the adverse party. The court is left without means of determining which part of the affidavit is based on belief and which part on the knowledge of the affiant.¹¹⁵ An affiant's belief may be based upon hearsay evidence which he, in good faith, believes to be true,¹¹⁶ but where a prima facie owner is about to be dispossessed of his property, the courts require more than good faith.¹¹⁷ The strict requirements outlined in *Johann* strive toward that goal, for if a court knew that the moving party's position and allegation were absolutely correct the prima facie owner would not, in fact, be entitled to the property and therefore his constitutional rights would not be violated by taking the property from him.

Not only do the courts require a great degree of certainty in the correctness of the affiant's statements, but furthermore, the affiant must state its position in terms of evidentiary facts, rather than conclusions.¹¹⁸ An analogous situation is the factual showing required of an affiant before a court in a criminal proceeding will issue a search warrant.¹¹⁹ The courts in such cases also strictly apply the rule¹²⁰ in

to, unless restrained and stopped, dissipate, conceal or embezzle such assets
before notice can be given.

314 N.E.2d at 824.

¹¹³Hizer v. Hizer, 201 Ind. 406, 414, 169 N.E. 47, 50 (1929); Spurgeon v. Rhodes, 167 Ind. 1, 7, 78 N.E. 228, 230 (1906).

¹¹⁴Ledger Publishing Co. v. Scott, 193 Ind. 683, 685, 141 N.E. 609, 609 (1923); Mannos v. Bishop-Babcock-Becker Co., 181 Ind. 343, 347, 104 N.E. 579, 580 (1914).

¹¹⁵Henderson v. Reynolds, 168 Ind. 522, 525, 81 N.E. 494, 495 (1907).

¹¹⁶*Id.* at 525-26, 81 N.E. at 496 (citing *City of Atchison v. Bartholow*, 4 Kan. 124, 139-40 (1866)).

¹¹⁷The court in *Indianapolis Mach. v. Curd*, 247 Ind. 657, 221 N.E. 340 (1966), held: Receivers may not be appointed *without notice* merely because a party "believes" that there is danger of loss of assets or merely because parties holding the assets "could" dissipate them or conceal them. The mere possibility or potentiality of doing injury or violating the law cannot be made the basis alone for equitable interference by a court. If such were the law, every person and every business would be subject to being taken over by a court, and even a court and a judge has such possibility and "could" violate the law.

Id. at 665, 221 N.E.2d at 345.

¹¹⁸*State ex rel. Red Dragon Diner v. Superior Court*, 239 Ind. 384, 386-87, 158 N.E.2d 164, 165-66 (1959).

¹¹⁹E.g., *Gwinn v. State*, 201 Ind. 420, 423, 166 N.E. 769, 770 (1929); *Wallace v. State*, 199 Ind. 317, 326, 157 N.E. 657, 660 (1927). The Wallace court held: "The affidavit or the statement under oath or affirmation, in support of probable cause, must bear the countenance of truth, which is so infallible that either an action for damages, or a criminal charge of perjury may be legally predicated thereon, if such statement is untrue." *Id.* at 326, 157 N.E. at 660.

¹²⁰E.g., *Wallace v. State*, 199 Ind. 317, 157 N.E. 657 (1927) wherein the court held:

order to protect the constitutional rights of the person to be searched. The appointment of a receiver without notice conceptually represents a more serious intrusion upon the constitutional rights of the party in possession than does granting of a search warrant.¹²¹

As in the case of the issuance of a search warrant, the court when considering the appointment of a receiver without notice demands specific facts from which it can determine whether or not appointment is justified. The court in *Inter-City Contractors v. Jolley*¹²² reversed the ex parte appointment of a receiver on the grounds that the verified complaint was deficient.¹²³ The concern of the court was the correctness of the appointment of a receiver without notice. In order to guarantee the constitutional rights of the party in possession, courts rely upon their own discretion in determining the justifiability of appointment in any particular case,¹²⁴ and therefore, independently review the facts.

Courts on a number of occasions have stated the specific facts required in order to justify the appointment of a receiver without notice.¹²⁵ Such facts include a showing that delay resulting from notice would defeat the object of the suit¹²⁶ and that a temporary restraining order or other alternate relief would be inadequate.¹²⁷ Additionally, the moving party must demonstrate to the court either that the party in possession: (1) Is about to waste or misappropriate the assets;¹²⁸ (2) is insolvent;¹²⁹ (3) is incapable of managing the

"Statutes which relate to search and seizure must be strictly construed in favor of the constitutional right of the people." *Id.* at 327, 157 N.E. at 660.

¹²¹Where a receiver is appointed without notice, the receiver enters the adverse party's business unannounced and literally takes away all control of it from him. A search warrant, on the other hand, only authorizes the search and seizure of particularly described articles. *Marron v. United States*, 275 U.S. 192 (1927). Thus, the appointment of a receiver without notice is the more drastic action.

¹²²257 Ind. 593, 277 N.E.2d 158 (1972).

¹²³The court held:

These conclusions are not supported by specific statements of facts sufficient to authorize the appointment of a receiver without notice under the authority of the above cited cases. The complaint of the appellee [party moving for appointment] does nothing more than allege conclusions which may or may not be supported by evidentiary facts.

Id. at 596-97, 277 N.E.2d at 160.

¹²⁴*Meek v. Steele*, 368 N.E.2d 257, 258 (Ind. Ct. App. 1977).

¹²⁵*E.g., Ledger Publishing Co. v. Scott*, 193 Ind. 683, 685, 141 N.E. 609, 609 (1923).

¹²⁶*Id.* at 685, 141 N.E. at 609.

¹²⁷*Id.* at 686, 141 N.E. at 609.

¹²⁸*Bookout v. Foreman*, 198 Ind. 543, 547, 154 N.E. 387, 388 (1926); *Henderson v. Reynolds*, 168 Ind. 522, 527, 81 N.E. 494, 496 (1907); *Mead v. Burk*, 156 Ind. 577, 580, 60 N.E. 338, 340 (1901); *Chicago & S.E. Ry. v. Cason*, 133 Ind. 49, 51, 32 N.E. 827, 828 (1892).

¹²⁹In the application for the appointment of a receiver to take over the assets of a corporation, insolvency is one of two statutory grounds. Although some courts have

assets;¹³⁰ (4) is without a right to the property;¹³¹ (5) is about to commit or has already committed a fraud upon the creditors or other parties petitioning for the appointment of the receiver;¹³² or (6) is about to remove the assets from the jurisdiction of the court.¹³³ In short there must be a showing of irreparable, unforeseeable injury to the moving party, if the receiver is not appointed.¹³⁴

The petitioning party not only must allege these facts as conclusions, but, based upon personal belief, swear to the facts which support such conclusions. If the moving party is able to demonstrate by a fair preponderance of the evidence that it will ultimately prevail on the merits when the case is finally adjudicated and the court is convinced that no other adequate remedy exists, then the court may, within the bounds of the constitutional guarantee of due process, appoint a receiver without notice to the adverse party. The statute requires sufficient cause to be shown before the notice re-

held that insolvency is not a required condition precedent to the appointment of a receiver without notice, *Mead v. Burk*, 156 Ind. 577, 581, 60 N.E. 338, 340 (1901), as a practical matter the absence of such an allegation makes the legal remedy appear available and thus defeats the application. See *Mannos v. Bishop-Babcock-Becker Co.*, 181 Ind. 343, 348, 104 N.E. 579, 581 (1914); *Goshen Woolen-Mills v. City Nat'l Bank*, 150 Ind. 279, 285, 49 N.E. 154, 156 (1898).

¹³⁰*Lafayette Realty Corp. v. Moller*, 247 Ind. 433, 438, 215 N.E.2d 859, 862 (1966). *But see North Am. Land & Timber Co. v. Watkins*, 109 F. 101, 105 (5th Cir. 1901) wherein the court considered the mismanagement issue:

Even where the management of the majority appears to be unwise and injurious, equity will not interfere if such management be not dishonest or ultra vires, but will require the complaining stockholder to seek relief within the corporation. When the management is not shown to be fraudulent or dishonest, and when it is a matter of opinion whether it is wise or unwise, advantageous, or disadvantageous, if the acts complained of be intra vires, there is no authority for equity to interfere. To do so would be to place control indirectly in the hands of the minority whenever interference removes from control the officers selected by the majority.

Id. at 105. See *Indianapolis Dairymen's Co-op. v. Bottema*, 226 Ind. 237, 247, 79 N.E.2d 401, 402 (1948). See also 2 R. TOWNSEND, SECURITIES AND CREDITOR'S RIGHTS 553 (1976).

¹³¹*Mead v. Burk*, 156 Ind. 577, 580, 60 N.E. 338, 339-40 (1901).

¹³²The application for the appointment of a receiver is an in rem proceeding; therefore, the moving party must have an interest in the property which is the subject matter of the action. See *Mead v. Burk*, 156 Ind. 577, 580, 60 N.E. 338, 339 (1901). See also 2 R. TOWNSEND, SECURITIES AND CREDITOR'S RIGHTS 556 (1976).

¹³³*Bookout v. Foreman*, 198 Ind. 543, 546, 154 N.E. 387, 388 (1926), *Chicago & S.E. Ry. v. Cason*, 133 Ind. 49, 51, 32 N.E. 827, 828 (1892). See 2 R. TOWNSEND, SECURITIES AND CREDITOR'S RIGHTS 555 (1976), for a listing of many additional grounds to justify the appointment of a receiver. See also *Henderson v. Reynolds*, 168 Ind. 522, 527-28, 81 N.E. 494, 495 (1907).

¹³⁴*Lafayette Realty Corp. v. Moller*, 247 Ind. 433, 439, 215 N.E.2d 859, 862 (1966); *Meyering v. Petroleum Holdings*, 227 Ind. 313, 325, 86 N.E.2d 78, 82 (1949); *Largura Constr. Co. v. Super-Steel Prods. Co.*, 216 Ind. 58, 61, 22 N.E.2d 990, 992 (1939); *Bookout v. Foreman*, 198 Ind. 543, 546-47, 154 N.E. 387, 388 (1926).

quirement can be obviated. The statute, however, does not define sufficient cause.¹³⁵

The court in *Johann* for the first time compiled all of the conditions and requisite showings that Indiana courts, for years, had independently demanded, into a single cohesive rule. Again, the uniqueness of the *Johann* holding is not the elements of the holding, but rather that all of the elements were gathered together in a concise, logical order.

C. The Development Of Indiana Case Law Since The *Johann* Decision

The cases which followed *Johann* either explicitly or implicitly applied the *Johann* rule without significant modification. The Indiana Supreme Court, in *Indianapolis Machinery Co. v. Curd*,¹³⁶ considered two additional elements to be satisfied before a court should appoint a receiver without notice: (1) An ex parte receivership should be temporary until notice and hearing,¹³⁷ and (2) the moving party should post a surety bond as in the case of a temporary restraining order.¹³⁸

The court did not, however, reverse the appointment of an ex parte receiver on those grounds.¹³⁹ Nor did the court state the elements in the form of a general rule.¹⁴⁰ Furthermore, the court decisions since *Indianapolis Machinery* have not made these elements part of the *Johann* rule.¹⁴¹

There is no reason for the courts not to require the same guarantees of protection in the appointment of a receiver without notice as required for the granting of a temporary restraining order

¹³⁵Henderson v. Reynolds, 168 Ind. 522, 526, 81 N.E. 494, 496 (1907); Wabash Ry. v. Dykeman, 133 Ind. 56, 65, 32 N.E. 823, 826 (1892).

¹³⁶247 Ind. 657, 221 N.E.2d 340 (1966).

¹³⁷*Id.* at 660, 221 N.E.2d at 342.

¹³⁸*Id.* at 667, 221 N.E.2d at 346.

¹³⁹*Id.* at 668, 221 N.E.2d at 346.

¹⁴⁰Instead, the court in dicta suggested:

The failure . . . , to require a bond under the circumstances, is a factor which weighs in the consideration of the propriety of the appointment without notice. The posting of a bond by the appellees could have minimized and reduced the severity of any likely injury to the appellants upon the appointment of a receiver, and such a fact cannot be eliminated in the consideration of the drastic remedy asked by the appellees for the appointment of a receiver without a notice and hearing.

Id. at 667, 221 N.E.2d at 346. Thus, although the court does not require the posting of a bond, whether or not a bond is posted does weigh in the court's determination.

¹⁴¹See, e.g., *Meek v. Steele*, 368 N.E.2d 257 (Ind. 1977); *Inter-City Contractors Serv., Inc. v. Jolley*, 257 Ind. 593, 277 N.E.2d 158 (1972); *Environmental Control Sys. v. Allison*, 314 N.E.2d 820 (Ind. Ct. App. 1974).

before notice. Although the effectiveness and expedient nature of the remedy would not in any way be impaired, and the moving party could still effect protection of the assets, yet the adverse party's rights would be greatly enhanced. The appointment would still be of an extraordinary nature and require satisfaction of the *Johann* conditions, but the chance of violating the constitutional rights of dispossessed parties would be greatly reduced.

V. CONCLUSION

The appointment of a state court receiver in Indiana is an anomaly. The statute specifically provides for the appointment of a receiver, and in certain limited situations justice between the parties can be served in no other way. Yet historically Indiana courts have only rarely affirmed an *ex parte* appointment. Furthermore, when compared to other extraordinary remedies such as a temporary restraining order there arises a serious question as to whether the *Johann* decision goes far enough in protecting the rights of the adverse party.

This leaves the practitioner in a predicament. Even if a factual situation arises which appears to fall within the allowable parameters for appointment without notice, he should carefully consider the alternatives even if such alternatives do not accord his client a full measure of relief. If a practitioner must seek the appointment of a receiver without notice, he is well advised to ask for a receiver to temporarily take control of the assets until notice can be given and a hearing held.¹⁴² In any event, the practitioner should scrupulously avoid the dangers inherent in the appointment of a receiver without notice.

STEVEN M. KIRSH

¹⁴²*Fagan v. Clark*, 238 Ind. 22, 148 N.E.2d 407 (1958) wherein the court suggested: The better practice, where the trial court finds it necessary to appoint a receiver without notice, is to provide in its order that the appointment should continue only so long as is necessary to give notice of a hearing to all interested parties. A prompt date for a hearing should be fixed and all interested parties should be given their day in court.

Id. at 31, 148 N.E.2d at 411.

Constitutionality of Retroactive Land Statutes—Indiana's Model Dormant Mineral Act

I. INTRODUCTION

Retroactive land statutes have been a central theme in the interaction of real property and constitutional limitations. Courts in the past have tested the constitutionality of such laws by poorly-conceived ideals. This Note will analyze dormant mineral statutes in relation to these ideals.

First, dormant mineral statutes will be placed in their constitutional context by comparing them with other retroactive land provisions. The blatant inconsistency produced when antiquated constitutional guidelines are applied to modern situations will become apparent. Next, a general survey of modern due process law will demonstrate the constitutional limitations that should be implemented with regard to retroactive statutes in general. Perhaps, dormant mineral statutes will be the area which will enable the courts to develop clear and consistent rules for the future.

II. THE PROBLEM AND THE LEGISLATIVE RESPONSE

A fee simple absolute is a possessory right to present enjoyment in every aspect of land, including the privilege to use minerals underneath the land. At common law, it was recognized that the right to this benefit may be severed from the fee title and be treated as a separate estate in the land.¹ This estate, known as a "severed mineral interest," may be fully owned and enjoyed as a fee in itself, separate from the right to use the surface interest.

The severed mineral interest, in conjunction with the American system of title recordation, creates a peculiar problem known as dormant mineral interests. Title to a mineral interest must be recorded,² and a title abstract must be obtained upon every new conveyance of the severed interest.³ The mineral estate becomes dormant if its owner can no longer be easily connected with its title.⁴ Due to the peculiar nature of a severed interest, parties desiring to acquire certain severed mineral rights may find it difficult or im-

¹See Polston, *Legislation, Existing and Proposed, Concerning Marketability of Mineral Titles*, 7 LAND & WATER L. REV. 73, 73-74 (1972).

²See, e.g., Silvers, *Abstracting in Oil and Gas Areas*, 36 TITLE NEWS 4 (1957).

³See, e.g., Deering, *Labyrinth of Royalty and Mineral Interests—A Survey* (pts. 1 & 2), 34 DICTA 195, 319 (1957).

⁴See generally Note, *Severed Mineral Interests, A Problem Without A Solution?*, 46 N. DAK. L. REV. 451 (1970).

possible to locate the owner even though his name on the recorded deed may be easily accessible in the county courthouse.⁵

For example, many problems originate during periods of oil and gas booms when thousands of fragmented interests are conveyed to opportunists or corporate speculators. The severed estates which are unprofitable to develop will lie buried in the recorder's office for years. Having nothing but fleeting connections in the mineral interest's locality, the speculative owners disappear leaving no trace other than their names on a deed in a title abstract. The severed fee owner may die without notifying his heirs of the severed interest. The problem emerges when a technical development, a fluctuation in market price, or the discovery of other valuable minerals makes a formerly worthless estate a valuable resource, thereby inducing the surface owner to engage in activity inconsistent with the rights of the owner of the severed interest.⁶

The problems which result from having these valuable mineral rights tied to inaccessible owners is a major defect in the system of title recordations.⁷ Besides unduly complicating abstracts,⁸ unused severed mineral interests infringe upon the right of the surface owner to utilize his land at its optimum capacity.⁹ A mineral servitude on the surface could deter certain types of investment in the surface estate—a resort hotel would hardly appreciate an oil rig on its beach.¹⁰ The energy crisis has been forwarded as another argument against mineral hinderances on marketability.¹¹ Oil companies will not invest in the expensive gamble of oil exploration if the title system offers only a plethora of dead abstracts with phantom owners. Such companies must be assured of good title to the oil they discover.¹²

⁵See *id.* at 451-52.

⁶For a discussion of the general problems of dormant mineral interests, see, P. BASYE, CLEARING LAND TITLES § 38, at 148-51 (2d ed. 1970).

⁷*Id.* at 143-51.

⁸*Id.*

⁹See Polston, *supra* note 1, at 73, 77.

¹⁰*Id.* at 77. For a case which discusses the societal ramifications of severing thousands of surface acres from their mineral interests, see Trustees of Tufts College v. Triple R. Ranch, Inc., 275 So. 2d 521 (Fla. 1973).

¹¹Bickel v. Fairchild, 83 Mich. App. 467, 470, 268 N.W.2d 881, 882 (1978).

¹²See Brief for Appellee at 13, *Wheelock v. Heath*, 201 Neb. 835, 272 N.W.2d 768 (1978):

Companies with an interest in exploration or development of minerals would not expend the large sums of money necessary for such exploration or development, unless they had a lease from the owners of all mineral interests when the mineral interests had been severed for many years, it became prohibitively expensive or physically impossible to locate the owners of the severed minerals. Sections 57-228 et seq. were adopted in response to this predicament.

The need for such relief is apparent in these proceedings. A number of

Attempts to deal with dormant mineral interests have involved the traditional approaches of adverse possession, marketable title statutes, and tax sales, but these methods have failed to deal effectively with the problem.¹³ Legislative schemes, commonly called dormant mineral statutes, may be the best if not the only answer.¹⁴ The Indiana statute¹⁵ requires the record mineral fee holder to either at-

the defendants did not receive the notice mailed to the last address of record. Of those defendants who apparently received notice, only a few believed the severed mineral interests to be of sufficient value to retain an attorney. There can be no exploration or development of these lands without elimination of those outstanding mineral interests, and Sections 57-228 et seq. provide a fair and workable solution to the problem.

¹³See Polston, *supra* note 1, at 74-79.

¹⁴See *id.* at 73-102. See also P. BASYE, *supra* note 6; L. SIMES & C. TAYLOR, THE IMPROVEMENT OF CONVEYANCING BY LEGISLATION, 239-47 (1960) [hereinafter cited as L. SIMES]; Smith, *Methods for Facilitating the Development of Oil and Gas Lands Burdened with Outstanding Mineral Interests*, 43 TEX. L. REV. 129 (1964); Street, *Need For Legislation to Eliminate Interests*, 42 MICH. ST. B.J. 49 (1963). For a list of jurisdictions which have adopted dormant mineral statutes, see note 19 *infra*.

¹⁵IND. CODE §§ 32-5-11-1 to 8 (1976) provide:

Sec. 6. Any interest in coal, oil and gas, and other minerals, shall, if unused for a period of 20 years, be extinguished, unless a statement of claim is filed in accordance with section five hereof, and the ownership shall revert to the then owner of the interest out of which it was carved.

Sec. 2. A mineral interest shall be taken to mean the interest which is created by an instrument transferring, either by grant, assignment, or reservation, or otherwise an interest, of any kind, in coal, oil and gas, and other minerals.

Sec. 3. A mineral interest shall be deemed to be used when there are any minerals produced thereunder or when operations are being conducted thereon for injection, withdrawal, storage or disposal of water, gas or other fluid substances, or when rentals or royalties are being paid by the owner thereof for the purpose of delaying or enjoying the use or exercise of such rights or when any such use is being carried out on any tract with which such mineral interest may be unitized or pooled for production purposes, or when, in the case of coal or other solid minerals, there is production from a common vein or seam by the owners of such mineral interests, or when taxes are paid on such mineral interest by the owner thereof. Any use pursuant to or authorized by the instrument creating such mineral interest shall be effective to continue in force all rights granted by such instrument.

Sec. 4. The statement of claim provided in section one above shall be filed by the owner of the mineral interest prior to the end of the twenty year period set forth in section two [one] or within two years after the effective date of this act, whichever is later, and shall contain the name and address of the owner of such interest, and description of the land, on or under which such mineral interest is located. Such statement of claim shall be filed in the office of the Recorder of Deeds in the county in which such land is located. Upon the filing of the statement of claim within the time provided, it shall be deemed that such mineral interest was being used on the date the statement of claim was filed.

Sec. 5. Failure to file a statement of claim within the time provided in

tempt to extract or discover minerals or to, at least, periodically record his intent to keep an active contact with his estate.¹⁶ The latter requirement—that of re-recording—is mandatory even though the estate is already properly registered. As seen above, notice means little if the record shows ownership by a speculator who has long since disappeared. The re-recording and use requirements unite the benefits of ownership of mineral rights with certain responsibilities to society. The penalty for failing to re-record or use the mineral estate is forfeiture of the interest.¹⁷ This forfeiture is the only practical way to eliminate interests which have become dormant,

section 4 shall not cause a mineral interest to be extinguished if the owner of such mineral interest:

- (1) was at the time of the expiration of the period provided in section four, the owner of ten or more mineral interests, as above defined, in the county in which such mineral interest is located, and;
- (2) made diligent effort to preserve all of such interests as were not being used, and did within a period of ten years prior to the expiration of the period provided in section 4 preserve other mineral interests, in said county, by the filing of statements of claim as herein required, and;
- (3) failed to preserve such interest through inadvertence, and;
- (4) filed the statement of claim herein required, within sixty (60) days after publication of notice as provided in section seven herein, if such notice is published, and if no such notice is published, within sixty (60) days after receiving actual knowledge that such mineral interest had lapsed.

Sec. 6. Any person who will succeed to the ownership of any mineral interest, upon the lapse thereof, may give notice of the lapse of such mineral interest by publishing the same in a newspaper of general circulation in the county in which such mineral interest is located, and, if the address of such mineral interest owner is shown of record or can be determined upon reasonable inquiry, by mailing within ten days after such publication a copy of such notice to the owner of such mineral interest. The notice shall state the name of the owner of such mineral interest, as shown of record, a description of the land, and the name of the person giving such notice. If a copy of such notice, together with an affidavit of service thereof, shall be promptly filed in the office of the Recorder of Deeds in the county wherein such land is located, the record thereof shall be *prima facie* evidence, in any legal proceedings, that such notice was given.

Sec. 7. Upon the filing of the statement of claim, provided for in section 4 of this chapter or the proof of service of notice as provided in section seven [six] of this chapter in the Recorder's office for the county where such interest is located, the Recorder shall record the same in a book to be kept for that purpose, which shall be known as the "Dormant Mineral Interest Record" and shall indicate by marginal notation on the instrument creating the original mineral interest the filing of the statement of claim or affidavit of publication and service of notice.

Sec. 8. The provisions of this chapter may not be waived at any time prior to the expiration of the twenty year period provided in section 1.

¹⁶*Id.* § 32-5-11-4.

¹⁷*Id.* § 32-5-11-1.

while still protecting active interests.¹⁸ The states¹⁹ which have adopted such measures generally provide that the mineral interest either lapses back into the estate "out of which it was carved."²⁰ In this way, the estate holder may succeed to a full fee ownership of the mineral estate.

III. THE CHALLENGES TO THE STATUTES AND THE RESPONSES

Three basic constitutional challenges have been leveled at dormant mineral statutes. The statutes: (1) effect a deprivation of property without due process of law,²¹ (2) violate privileges and immunities clauses by unequal protection due to arbitrary distinctions between classes,²² or (3) retroactively impair contractual

¹⁸See Polston, *supra* note 1, at 94-101.

¹⁹See FLA. STAT. ANN. § 704.05 (Supp. 1978) (applied prospectively only); GA. CODE § 85-407.1 (1978); ILL. REV. STAT. ch. 30, §§ 197-98 (1973); IND. CODE §§ 32-5-11-1 to 8 (1976); MICH. COMP. LAWS § 554.291 (1970) (declared unconstitutional by court of appeals); NEB. REV. STAT. § 57-229-230 (1974); N.C. GEN. STAT. § 1-42.1 (1969); TENN. CODE ANN. § 64-704 (Supp. 1978); VA. CODE § 55-154 (1974); WIS. STAT. § 700.30 (1978) (held unconstitutional).

At the present time, three states have suits pending concerning dormant mineral statutes: Illinois, Indiana, and Michigan. Michigan's statute was recently declared unconstitutional by the court of appeals, but is now awaiting appeal to the Michigan Supreme Court. See *Bickel v. Fairchild*, 83 Mich. App. 467, 268 N.W.2d 881 (1978). In Indiana, a trial court has declared Indiana's act unconstitutional. See *Pond v. Walden*, No. C-78-17 (Gibson Cir. Ct., Ind. July 24, 1978); *Short v. Texaco, Inc.*, No. C-77-248 (Gibson Cir. Ct., Ind. Sept. 18, 1978). Wisconsin is the only state with a supreme court decision that directly addresses all aspects of the problem, including the result of a retroactive application of the statute. See *Chicago & N.W. Transp. Co. v. Pedersen*, 80 Wis. 2d 566, 259 N.W.2d 316 (1977) (holding unconstitutional the Wisconsin statute). The Nebraska statute was held unconstitutional by the Nebraska Supreme Court. See *Wheelock v. Heath*, 201 Neb. 835, 272 N.W.2d 768 (1978).

Other states have decisions which either involve exceptions to the standard form of mineral statutes or have applied them only prospectively. See *Trustees of Tufts College v. Triple R. Ranch, Inc.*, 275 So. 2d 521 (Fla. 1973) (applied only prospectively due to a lack of a grace period); *Nelson v. Bloodworth*, 238 Ga. 264, 232 S.E.2d 547 (1977); *Love v. Lynchburg Nat'l Bank & Trust Co.*, 205 Va. 860, 140 S.E.2d 650 (1965) (retroactively applied a rebuttable presumption as a rule of evidence to escape constitutional objections).

²⁰IND. CODE § 32-5-11-1 (1976). See also MICH. COMP. LAWS § 554.291 (1970).

²¹U.S. CONST. amend. XIV, § 1; IND. CONST. art. 1, § 21.

²²U.S. CONST. amend. XIV, § 1; IND. CONST. art. 1, § 23. Indiana's statute seems especially vulnerable to this attack because the inadvertence clause, IND. CODE § 32-5-11-5 (1976), excepts large mineral holders, who own 10 or more mineral interests in a county, from liability due to a failure to file. This quantitative distinction is not arbitrary or irrational in light of the interests they attempt to protect. See *City of New Orleans v. Dukes*, 427 U.S. 297 (1976); *State Bd. of Tax Comm'r's v. Jackson*, 283 U.S. 527 (1931). In the drafting of this legislation coal companies insisted on such an exception due to the poor state of their records. See Polston, *supra* note 1, at 100. Interests skipped would, therefore, be a part of a general development scheme and the policy

obligations.²³ Only the first and third objections will be discussed because they present the most pervasive as well as the most persuasive arguments.²⁴

A. *The First Line of Defense—Analogies between Dormant Mineral Statutes and Statutes of Limitation*

The objections to dormant mineral statutes center on their retroactive application. To be effective, these statutes must apply to interests already vested—namely, dormant interests without readily accessible owners. Such dormant mineral interests will remain uselessly static for years, unless affected by the challenged statutes.²⁵ Yet, the virtues of the dormant mineral statutes are the very points which open them to criticism.

Generally, a prospective act that is reasonably drafted and applied suffers no constitutional challenges.²⁶ In the case of property, prospective application limits the types of transactions which can be entered, foreclosing only expectations. In comparison, retroactive laws add or subtract duties or privileges to transactions which have occurred.²⁷ Acts altering vested property rights may, in a sense, take legally fixed privileges. When laws begin to affect values

reasons for applying a strict rule would be absent especially in the light of the required "deliberate effort" to comply with the statute. In fact, "holes" in a general scheme of coal development were one of the problems which Indiana's model statute sought to remedy. *See id.* at 82.

The Virginia statute has withstood a denial of equal protection argument. *See Love v. Lynchburg Nat'l Bank & Trust Co.*, 205 Va. 860, 140 S.E.2d 650 (1965). An unequal protection argument was also made against the Michigan statute, which is directed only against oil and gas interests. Apparently, the objection was that oil and gas owners receive less protection than solid mineral owners. *See Brief for Appellee* at 21-22, *Bickel v. Fairchild*, 83 Mich. App. 467, 268 N.W.2d 881 (1978). Again, the question was whether the distinction is rational and neither capricious nor arbitrary. Of course, the obvious answer is that oil and gas interests are subject to much more speculation than coal or other solid minerals. *See P. BAYSE, supra* note 6, § 38. Coal requires a stable developer and long term plans. Prices and technology in the area are not so wildly fluctuating. *Id.* Neither the trial court nor the appellate court in *Bickel* reached this argument.

Finally, the Indiana statute could be condemned as an unlawful delegation of legislative power. IND. CONST. art. 1, § 25. This allegation's only rational basis would rest on the other arguments and whether the legislature had over-stepped due process limits.

²³U.S. CONST. art. 1, § 25.

²⁴Some courts treat due process and the contract clause as identical. *See Heiner v. Donnan*, 285 U.S. 312, 326 (1932). The distinction, however, will become clear later in this Note.

²⁵See Polston, *supra* note 1, at 73-74.

²⁶See L. SIMES, *supra* note 14, at 256.

²⁷For a more precise definition of retroactive, see Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 CAL. L. REV. 216 (1960).

already acquired, those laws have been condemned as retroactively depriving persons of their vested property rights.²⁸

Citing retroactive application, opponents of dormant mineral statutes anchor their arguments in old constitutional prohibitions against altering vested rights.²⁹ Ideally, vested rights could never be impaired by legislation; hence, the right to the use or non-use of property was practically absolute.³⁰ Once they became static, legally fixed, or vested with present enjoyment in their title owner, the constitutional prohibition against deprivation of property without due process or just compensation protected such rights from almost any impairment.³¹ Even though courts began to recognize early that the vested rights doctrine held little resemblance to legislative policy necessities,³² many tribunals apparently still employ the doctrine as a confusing constitutional limitation.³³

The opponents of the dormant mineral statutes utilize the courts' confusion on this issue by condemning the statutes for retroactively impairing vested rights. In *Bickel v. Fairchild*³⁴ the trial court accepted this argument: "'Courts, as a rule, are loath to give retroactive effect to statutes, and this is especially so when, by so doing, it would disturb contractual or vested rights.'"³⁵ An exception to the old vested rights doctrine, if taken literally, would still have prohibited any government alterations of rights already established. As long as the retroactive law affected only a "remedy," and not the corresponding right that the remedy was meant to enforce, the substantive relationships between the parties remained unaltered.³⁶ Legislation could have a retroactive effect if the law merely rearranged procedural mechanisms by which rights were enforced.³⁷ Implicit in this doctrine was the limitation that remedies

²⁸*Id.* at 218.

²⁹See, e.g., Brief for Defendant at 10, *Short v. Texaco, Inc.*, No. C-77-248 (Gibson Cir. Ct., Ind. Sept. 18, 1978).

³⁰See *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819).

³¹See *Evans-Snider-Buel Co. v. McFadden*, 105 F. 293, 300 (8th Cir. 1900) (stating that vested rights "may, with reasonable precision, be held to mean some rights or interest in property that has become fixed or established, and is no longer open to doubt or controversy").

³²See, e.g., *West River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507 (1848).

³³16 C.J.S. *Constitutional Law* § 226 (1963) provides: "The legislature has no power to alter or to destroy by statute the nature or tenure of vested estates in property." For a similar statement, see 5 I.L.E. *Constitutional Law* § 101 (1958).

³⁴83 Mich. App. 467, 268 N.W.2d 881 (1978).

³⁵No. 77-1225 (Montmorency Cir. Ct., Mich.), *aff'd*, 83 Mich. App. 467, 268 N.W.2d 881 (1978) (quoting *Nash v. Robinson*, 226 Mich. 146, 149, 197 N.W. 522, 524 (1924)). The *Nash* court continued: "There are, however, exceptions to the rule, and one of them is in relation to remedial legislation." *Id.*

³⁶See, e.g., *Bronson v. Kinzie*, 42 U.S. (1 How.) 311, 317-20 (1843).

³⁷*Id.*

could not be altered to impair the enforcement of the corresponding right.³⁸ Throughout the history of the interaction between constitutional and property law, this distinction between right and remedy has been crucial and, in most cases, dispositive.³⁹

For example, statutes of limitations have always been viewed as procedural measures, and do not, therefore, affect substantive rights, but merely alter the remedies by which those rights are enforced.⁴⁰ Similarly, the constitutional justification for adverse possession statutes in some cases has centered on this distinction between rights and remedies, and the courts have held that such statutes do not effect a transfer of title which would alter vested property rights, but merely bar a remedy for trespass.⁴¹ The title owner has a cause of action against his disseisor. If the wronged party "sleeps on his rights," social policy and laches demand death for stale claims and final repose for the wrongdoer. The legislature can shorten or lengthen the period in which the action can be brought only if it affects the remedy for recovery of the property and not the right itself.⁴² Moreover, the extent of the limitation on the remedy must be confined to allow the wronged party a "reasonable" time to vindicate his right.⁴³

The proponents of dormant mineral statutes argue that mineral acts, like adverse possession statutes, change only the remedies of parties, not their rights. The proponents claim that the statutes merely alter the criteria for successful adverse possession of mineral rights.⁴⁴ Superficially, this assertion has some merit. Before the enactment, actual possession of the surface estate was not enough to effect a transfer of corresponding severed estates. The disseisor was required to actually "possess" the minerals by an active attempt to extract them from the land.⁴⁵ After the enactment, possession of the surface estate, or at least the estate out of which

³⁸See *Pritchard v. Spencer*, 2 Ind. 486 (1851). A new statute of limitations for merchant contracts which was applied retroactively was held to be within the power of the legislature as long as a reasonable grace period was provided. *Id.* at 487-88.

³⁹See, e.g., *Worthen Co. v. Kavanaugh*, 295 U.S. 56, 60 (1935).

⁴⁰See, e.g., *Chase Sec. Corp. v. Donaldson*, 325 U.S. 304 (1945); *Campbell v. Holt*, 115 U.S. 620 (1885); *Bronson v. Kinzie*, 42 U.S. (1 How.) 288 (1843); *Gilbert v. Selleck*, 93 Conn. 412, 106 A. 439 (1919); *In re Daniel's Estate*, 208 Minn. 420, 294 N.W. 465 (1940); *Bates v. Collum*, 177 Pa. 633, 35 A. 861 (1896).

⁴¹See, e.g., *Steele v. Gellatly*, 41 Ill. 39, 43 (1866). See also cases cited in P. BASYE, *supra* note 6, § 56, at 191 n.5.

⁴²See generally Corwin, *The Basic Doctrine of American Constitutional Law*, 12 MICH. L. REV. 247 (1914).

⁴³See, e.g., *Wheeler v. Jackson*, 137 U.S. 245 (1890).

⁴⁴See, e.g., Brief for Defendant at 8-9, *Short v. Texaco, Inc.*, No. C-77-248 (Gibson Cir. Ct., Ind. Sept. 18, 1978).

⁴⁵McBeth v. Wetnight, 57 Ind. App. 47, 53-56, 106 N.E. 407, 410 (1914).

the severed fee was carved, entailed a possession of the mineral interests as well.⁴⁶ If the mineral title owner failed either to use his severed interest or re-record, his inactivity would be punished by a transfer of title in favor of the disseisor surface owner.⁴⁷ Furthermore, in both adverse possession and dormant mineral situations, inactivity of the title owner justifies the bar of a limitation on remedies and a subsequent change in title. Proponents assert that this analogy assures the constitutionality of mineral statutes because, just as adverse possession statutes, mineral acts affect remedies and not substantive rights.

These claims may also be supported by comparisons to the doctrines of incorporeal hereditaments and liberative prescription.⁴⁸ Severed mineral interests in Indiana are regarded as "incorporeal hereditaments," a category which includes servitudes or easements on land.⁴⁹ Incorporeal hereditaments may be adversely possessed by the fee estate owner if the hereditament owner failed to continue an active use of his interest.⁵⁰ The proponents of the statutes claim that

⁴⁶See IND. CODE § 32-5-11-1 (1976).

⁴⁷See *id.*

⁴⁸"Corporeal" interests are the more concrete or substantial estates in land. They are generally distinguished from other estates because they can be seen, handled, or touched. A "hereditament" is a general term used to refer to almost all interests in real estate that can be inherited. The term "corporeal hereditament" is employed to describe the more substantial estates in land. See BLACK'S LAW DICTIONARY 859 (rev. 4th ed. 1968). "Incorporeal," however, is defined as a right which stems from the corporeal estate. These rights cannot be seen or handled but are merely abstractions. See *id.* For example, a fee simple absolute is corporeal because it may be felt. On the other hand, an easement is incorporeal. See 73 C.J.S. *Property* § 7, at 167-68 (1955).

Because incorporeal hereditaments are not as substantial as corporeal estates, the law has afforded incorporeal title owners less security of ownership. Incorporeal hereditaments could be abandoned at common law with the title reverting to the corresponding corporeal hereditament out of which it was carved. See note 50 *infra*. At least in Louisiana, it is possible for the owner of a corporeal estate to adversely possess the incorporeal interests that stem from his land. This adverse possession, known as liberative prescription, begins whenever the owner of the incorporeal estate fails to use his right for a long period of time. After a period of consistent nonuse, the incorporeal interest becomes a part of its corporeal estate. If a mineral interest (treated as an incorporeal hereditament in Louisiana) is not used, the mineral holding will be forfeited to the owner of the corresponding corporeal hereditament. See Nabors, *The Louisiana Mineral Servitude and Royalty Doctrines: A Report to the Mineral Law Committee of the Louisiana State Law Institute*, 25 TULANE L. REV. 30 (1950); Polston, *supra* note 1, at 81-88. See also W.L. SUMMERS, THE LAW OF OIL AND GAS § 139 (1954 & Supp. 1978).

⁴⁹Heller v. Dailey, 28 Ind. App. 555, 564, 63 N.E. 490, 493 (1902).

⁵⁰This statement is somewhat broad. At common law, an *incorporeal* hereditament could at least be abandoned. See, e.g., Tietjen v. Meldrim, 169 Ga. 678, 151 S.E. 349 (1930). However, perfect legal title to a *corporeal* hereditament could not be abandoned despite long periods of nonuse. See, e.g., Duncan v. Mason, 239 Ky. 570, 39 S.W.2d 1006 (1931).

the enactment merely extends the rules of adverse possession and incorporeal hereditaments to include mineral interests.

Marketable title acts⁵¹ and recording statutes⁵² constitute further analogies employed by the mineral statutes' defenders.⁵³ Marketable title acts were meant to clear up ambiguities in the American system of title recordation.⁵⁴ Any title chain may have outstanding defects which leave doubts about marketability. For social policy reasons, marketable title acts require the beneficiaries of such interests to re-record in a similar manner as is required by dormant mineral statutes.⁵⁵ This re-recording must be performed to prevent forfeiture of the interest.⁵⁶ Thus, recording statutes may effect a forfeiture of title which in common law was recognized as fully vested.⁵⁷ The failure to record in both instances justifies the loss of title, yet, unlike dormant mineral acts, the constitutionality of marketable title and recording acts is firmly established.⁵⁸ In all of these cases, *the inactivity of the estate holder* becomes the basis of a title transfer in the name of social policy.

"Yet, none of these laws—marketable title acts . . . or, adverse possession statutes—has the intended effect of taking a clear and unchallenged title from its owner and giving it to a person who has *not even a claim to it*."⁵⁹ In other words, the attackers of the dormant mineral statutes declare that the above dichotomy sufficiently distinguishes mineral statutes from the other limitation statutes mentioned. In the case of adverse possession, the wronged party has

⁵¹See Proposed Model Marketable Title Act, reprinted in L. SIMES, *supra* note 14, at 6. See also IND. CODE §§ 32-1-5-1 to 10 (1976).

⁵²See Proposed Model Recording Act, reprinted in UNIFORM ACTS: LAND TRANSACTIONS - SIMPLIFICATION OF LAND TRANSFERS - CONDOMINIUMS 204 (1978). See also IND. CODE § 32-1-2-16 (1976).

⁵³Brief for Plaintiff at 11, *Short v. Texaco, Inc.*, No. C-77-248 (Gibson Cir. Ct., Ind. Sept. 18, 1978).

⁵⁴See J. SCURLOCK, RETROACTIVE LEGISLATION AFFECTING INTERESTS IN LAND, 80-85 (1953).

⁵⁵See P. BASYE, *supra* note 6, at 148-51.

⁵⁶Compare IND. CODE § 32-5-11-4 (1976) (mineral statute) with *id.* § 32-1-5-4 (marketable title act).

⁵⁷IND. CODE § 32-1-2-16 (1976). See also *Sills v. Lawson*, 133 Ind. 137, 32 N.E. 875 (1892) (recognizing common law rule that an unrecorded deed is good against everyone except subsequent purchasers for value who record first).

⁵⁸See *American Land Co. v. Zeiss*, 219 U.S. 47 (1911); *City of Miami v. St. Joe Paper Co.*, 347 So. 2d 622 (Fla. Dist. Ct. App. 1977); *Tesdell v. Hanes*, 248 Iowa 742, 82 N.W.2d 119 (1957); *Wichelman v. Messner*, 250 Minn. 88, 83 N.W.2d 800 (1957). See also L. SIMES, *supra* note 14, at 253; *Aigler, A Supplement to "Constitutionality of Marketable Title Acts,"* 1951-1957, 56 MICH. L. REV. 225 (1957); Annot., 71 A.L.R.2d 846 (1960).

⁵⁹Brief for Appellee at 10, *Bickel v. Fairchild*, 83 Mich. App. 467, 268 N.W.2d 81 (1978).

a suit in ejectment against the disseisor from the moment the trespass begins.⁶⁰ Laches will take effect because the wronged party was *inactive only inasmuch as he failed to bring an action at law to recover his rights* after being notified of the challenge to them. Similarly, marketable title acts limit the time period in which the holder of a competing claim or defect in a chain of title can remain inactive before his claim will be extinguished. Such statutes "are designed to deal with conflicting claims of the title on the same piece of property. The Mineral Lapse Statute . . . deals with non-conflicting claims in separate and independent titles."⁶¹ With mineral interests statutes, no dispute arises as to competing rights to the same title. The mineral owner's rights are unquestioned until his estate is forfeited by the operation of the statute; thus, he has no need or chance to have a legal remedy until it is too late. He is *inactive only because he has no reason or legal basis to act*. For these reasons, opponents argue that comparisons between dormant mineral statutes and marketable title or adverse possession legislation are inappropriate.

To fully understand this argument, one must clearly delineate between rights, remedies, and causes of action. A remedy is related to a situation in which the law recognizes that a right has been violated. The remedy, therefore, is the procedure by which the right is vindicated. Obviously, the law recognizes only a limited number of violations of rights. These violations correspond to particular facts or conditions called "causes of action." The presence of the cause of action activates the procedural mechanism which will rectify a deprivation of rights.⁶²

No one has a vested right in a remedy because it is merely a medium through which rights are enforced;⁶³ however, if a remedy is limited or abolished by a statute of limitation *before the cause of action accrues*, a constitutionally protected right is impaired. While the right remains theoretically intact, the courts no longer provide a forum to enforce it. A legally recognized right without legally recognized methods to protect it is, of course, practically useless. The general rule seems to demand, therefore, that the cause of action be realized before the remedy can be affected by any statute of limitations: "The period of a statute of limitations that bars the right of an owner to recover his land and divests him of his owner-

⁶⁰See, e.g., IND. CODE § 34-1-48-1 (1976).

⁶¹Brief for Defendant at 12, Short v. Texaco, Inc., No. C-77-248 (Gibson Cir. Ct., Ind. Sept. 18, 1978).

⁶²For a similar analysis, see Bronson v. Kinzie, 42 U.S. (1 How.) 288, 294-95 (1843).

⁶³See, e.g., Chase Sec. Corp. v. Donaldson, 325 U.S. 304 (1945).

ship of it does not begin to run until there accrues to him a cause of action to recover the land."⁶⁴

In the light of the above concepts, the opponents' argument can be better understood⁶⁵—mineral statutes allow no cause of action or remedy to arise before the title owner's substantive rights are terminated, while, on the other hand, statutes of limitation affect remedies only after a cause of action has accrued thereby allowing the threatened owner his day in court. For example, in the case of adverse possession, the disseisor is actively challenging the rights of title owners. At the moment possession occurs on the disseisor's part, a cause in ejectment arises as a remedy for the record title holder.⁶⁶ In turn, as the remedy becomes viable, a statute of limitations begins to limit the title owner's right to the ejectment remedy—not his right to his property. In the case of a dormant mineral statute, a remedy at law for the redress of active wrongs on the part of the disseisor is never activated. A remedy never existed; hence, one may not claim that a mineral act limits only remedies. No one challenges the title owner's rights until the statute itself penalizes the owner's inactivity. The disseisor merely sits nearby exercising his domain over a totally different estate in the land—the surface—and in no sense is challenging the mineral owner's title.

This point must be conceded to the mineral statutes' attackers. Certain types of statutes of limitation, such as adverse possession provisions, can be easily distinguished from mineral acts. Yet, not all types of statutes of limitation can be differentiated from dormant mineral legislation. There are three different ways in which a remedy might be limited. First, the legislature may shorten the period in which one may bring his grievance to court *after the cause of action activating a remedy* has arisen. This type is a true statute of limitations and will be known hereinafter as a "statute of limitations." Second, a legislature may abolish a remedy altogether as long as another remedy is reasonably available to vindicate the corresponding right. Hereinafter, this type will be called an "abolition of remedy" statute.⁶⁷ Finally, the legislature may abolish a right for

⁶⁴Day, *Curative Acts and Limitations Acts Designed to Remedy Defects in Florida Land Titles—IV*, 9 U. FLA. L. REV. 145, 159 (1956); accord, Grayson v. Harris, 279 U.S. 300 (1929); Redfield v. Parks, 132 U.S. 239 (1889).

⁶⁵See note 59 *supra* and accompanying text.

⁶⁶See, e.g., IND. CODE § 34-1-48-1 (1976).

⁶⁷See, e.g., *id.* §§ 32-8-4-1, -2 (in which the foreclosure on a mortgage is barred 20 years after its due date as designated on the recorded instrument). These statutes may be said to abolish a remedy. Twenty years after the due date on the mortgage instrument, a foreclosure on the property as a remedy for the non-payment of the secured debt would be barred by the statute. These types of statutes have been adjudged constitutional, however, because they allow a re-recording to preserve the interests and

implicit social policy reasons under the guise of limiting a remedy. This goal is accomplished by limiting, or, more accurately, abolishing a remedy *before the cause of action has arisen*. Since the limited remedy is usually the only avenue to vindicate its corresponding right, the right is, for practical purposes, negated. Hereinafter, this type of enactment will be referred to as a "pseudo-statute of limitations."⁶⁸

It follows from the above comparisons and classifications that dormant mineral statutes are pseudo-statutes of limitation because they limit remedies before the cause of action has accrued. Until recently, pseudo-statutes of limitation were seen as unconstitutional.⁶⁹

For instance, to promote marketable titles, legislatures have passed adverse possession statutes which did not except non-possessory estates or claimants with disabilities from the disseisor's claims.⁷⁰ These statutes usually purport to vest absolute title in the adverse possessor free of even the vested rights of remaindermen as long as the disseisor took possession under color of title and paid taxes.⁷¹

The courts,⁷² however, refused to apply such color of title adverse possession statutes to future interests because they limited

are therefore, permissible. See *Yarlott v. Brown*, 192 Ind. 648, 138 N.E. 17 (1923); *Evans v. Finley*, 166 Ore. 227, 111 P.2d 833 (1941).

⁶⁸For an example of a pseudo-statute of limitation, see IND. CODE § 33-1-1.5-5 (Supp. 1978) (providing a limitation period for product liability actions).

⁶⁹See, e.g., *Chapman v. County of Douglas*, 107 U.S. 348 (1882); *Sohn v. Waterson*, 84 U.S. (17 Wall.) 596 (1873); *Coleman v. Superior Court*, 135 Cal. App. 74, 26 P.2d 673 (1933); *Slover v. Union Bank*, 115 Tenn. 347, 89 S.W. 399 (1905). Today, however, pseudo-statutes of limitation, especially in the area of products liability, are increasingly accepted by the courts as a legitimate exercise of the legislative police power. See *Smith v. Allen-Bradley Co.*, 371 F. Supp. 698 (W.D. Va. 1974); *Hargraves v. Brackett Stripping Mach. Co.*, 317 F. Supp. 676, 681-83 (E.D. Tenn. 1970).

⁷⁰See, e.g., ILL. REV. STAT. ch. 83, § 6 (1973) which provides:

Every person in the actual possession of lands or tenements, under claim and color of title, made in good faith, and who shall for seven successive years, continue in such possession, and shall also, during said time, pay all taxes legally assessed on such lands or tenements, shall be held and adjudged to be the legal owner of said lands or tenements, to the extent and according to the purport of his or her paper title. All persons holding under such possession, by purchase, devise or descent, before said seven years shall have expired, and who shall continue such possession, and continue to pay the taxes as aforesaid, so as to complete the possession and payment of taxes for the term aforesaid, shall be entitled to the benefit of this section.

For a list of similar statutes, see P. BASYE, *supra* note 6, § 56.

⁷¹See P. BASYE, *supra* note 6, § 56.

⁷²*Beasley v. Beasley*, 404 Ill. 225, 88 N.E.2d 435 (1949) (holding statutes of limitation do not run against remaindermen until the right of entry accrues); *Steele v. Gellatly*, 41 Ill. 39 (1866) (rejecting the objection that limitation laws operate on titles

a remedy before its cause of action had arisen.⁷³ The vital question in these situations was whether the aggrieved party presently possessed a cause of action. Until the remainderman gained a possessory right, thereby activating the possibility of an action in ejectment, he would be helpless to protect his rights through any legal action. The disseisor, even though in possession of the questioned estate for the last twenty years, could not make any constitutional claim against the remainderman.⁷⁴ The disseisor claimed only a right to possession and could not challenge a remainderman's interest since the remainderman had no right to present possession.

The courts concluded that all statutes of limitation were based upon a theory of laches, and no laches could be imputed to a future interest holder who had no remedy or cause of action.⁷⁵ In *Mettler v. Miller*,⁷⁶ the Illinois Supreme Court stated: "To hold [otherwise] would be to deprive such person of his estate without his day in court."⁷⁷

The adverse possession color of title statutes and their effect on future vested interests may be compared to the Model Marketable Title Act.⁷⁸ If the courts had applied these adverse possession statutes to future interests, it seems apparent that the above provisions would have operated as "pseudo-statutes of limitation" and would have been subject to due process objections. Yet, the Model Marketable Title Act, generally recognized as constitutional,⁷⁹ applies to all interests "however denominated, whether legal or equitable, present or future."⁸⁰ In other words, the Model Marketable Title Act applies to future interests in a manner which was forbidden by the courts when they dealt with the constitutionality of adverse possession color of title statutes. Thus, the Model Act may also be subject to the same due process objections as those encountered by the adverse possession color of title statutes. Both are pseudo-statutes of limitation.

and refusing to apply the statute to future interests). See generally P. BASYE, *supra* note 6, § 56, at 191 n.5.

⁷³See *Steele v. Gellatly*, 41 Ill. 39, 44 (1866).

⁷⁴*Id.* But cf. *Lewis v. Barnhart*, 145 U.S. 56 (1891) (Illinois statute applied to a remainder interest).

⁷⁵See authorities cited in note 72 *supra*.

⁷⁶129 Ill. 630, 22 N.E. 529 (1889).

⁷⁷*Id.* at 643, 22 N.E. at 532.

⁷⁸See note 51 *supra*.

⁷⁹See authorities cited note 58 *supra*.

⁸⁰Proposed Model Marketable Title Act § 3, reprinted in L. SIMES, *supra* note 14, at 8. See also P. BASYE, *supra* note 6, § 52, at 180. The author stated: "Marketable Title Acts have been drafted to bar *all possible claims without exception*, including those . . . of owners of future interests . . ." *Id.* (emphasis added).

One distinction does exist. *Marketable title acts* allow re-recording to preserve future interests⁸¹ whereas *adverse possession color of title statutes* do not. Dormant mineral statutes also allow re-recording to preserve the questioned interests and, therefore, may be justified in a similar manner.

For instance, *A*, owner in fee simple, conveys Blackacre to *B* for life, remainder to *C* and his heirs. *B* and *C* record the transaction and have full knowledge of each other's interests. Later, *A* plans to defraud *C* and conveys Blackacre to *B* again, but this time *A* gives *B* a warranty deed for value purporting to give *B* Blackacre's remainder. *B* records the deed and remains in possession of Blackacre for sixty years and dies. Under Indiana recording laws,⁸² since *B* took the deed with constructive notice of *C*'s interest, if *C* took possession of Blackacre upon *B*'s death, *B*'s heirs would have no cause of action.⁸³ Any claim by *B*'s heirs would have to be based on a void fraudulent deed that would not be recognized past the pleading stages in any suit to recover Blackacre.⁸⁴ Clearly, *C* has a vested remainder, a substantial property right, which is fully alienable.⁸⁵

Assume, however, that Indiana's Marketable Title Act⁸⁶ went into effect in Blackacre's jurisdiction. The act has a traditional grace period and a fifty year re-recording requirement in order to preserve an adverse claim to any root of title including one based on an otherwise fraudulent or void deed.⁸⁷ Assume further that *B*'s warranty deed had been on record fifty years at the time the act went into effect. *C*, like most laymen, neither knew of the cloud cast on his title nor of his duty to re-record in order to preserve his interest. Indeed, he would have no reason to know of *A*'s plan. As a result, *C* failed to re-record. Logically, according to the terms of the act, *B* would have clear title in fee simple two years after the passage of the act. The act effected a forfeiture of *C*'s interest before *C* gained a possessory right.

The Model Marketable Title Act does exactly what courts in the past have considered to be unconstitutional and, as such, is a pseudo-statute of limitations similar to the color of title adverse possession statutes and dormant mineral acts.⁸⁸ In the above exam-

⁸¹See, e.g., IND. CODE § 32-1-5-4 (1976).

⁸²Id. § 32-1-2-16 (1976).

⁸³See *id.*

⁸⁴See *id.*

⁸⁵See *Kost v. Foster*, 406 Ill. 565, 94 N.E.2d 302 (1950).

⁸⁶IND. CODE §§ 32-1-5-1 to 10 (1976). Indiana adopted the Model Marketable Title Act without substantial change. See Note, *The Indiana Marketable Title Act of 1963: A Survey*, 40 IND. L.J. 21 (1964).

⁸⁷IND. CODE § 32-1-5-4 (1976) (act applies to all interests). See also *City of Miami v. St. Joe Paper Co.*, 347 So. 2d 622 (Fla. Dist. Ct. App. 1977).

⁸⁸See notes 70-79 *supra* and accompanying text.

ple, *C* had no possessory right when the Marketable Title Act effected a forfeiture of his vested remainder. His remedy was limited before his cause of action accrued. Even though marketable title acts operate on future interests in the same way that color of title adverse possession statutes were intended to operate by the legislatures, the courts have consistently found marketable title acts to be constitutional.⁸⁹

But, as asserted above, a saving distinction does exist between color of title adverse possession statutes and marketable title acts. Color of title adverse possession statutes do not afford future estate holders such as *C* a chance to preserve their interests.⁹⁰ In comparison, marketable title and dormant mineral acts provide a "remedy" by affording an opportunity to re-record. Re-recording, while not a remedy in the usual legal sense,⁹¹ does provide a viable redress by which the title owner can protect his interest and does not arbitrarily terminate his property rights. Since both statutes allow re-recording to preserve the interests of all parties as a "remedy" against possible forfeitures of property interests,⁹² the conclusion is inescapable that, if dormant mineral statutes are unconstitutional,⁹³ marketable title acts must also be found void. This result seems unlikely even though the Michigan Court of Appeals found that state's mineral statute unconstitutional.⁹⁴ One court justified these statutes as follows: "Marketable title acts merely require filing notice rather than commencing an action; hence they may apply to vested future interests."⁹⁵

Nevertheless, some objections can be made to the above argument. First, the examples above deal solely with non-possessory interests in land. On the other hand, dormant mineral statutes effect the forfeiture of fully vested mineral interests with present rights to enjoyment. Since future interests are non-possessory, one could argue that they are less valuable and deserve less constitutional protection. These arguments have no merit. A vested future interest is as substantial as an oil potentiality.⁹⁶ Indeed, an oil well seems merely speculative when compared to the certainty of a vested remainder. Moreover, the Model Marketable Title Act applies to

⁸⁹See authorities cited in note 58 *supra*.

⁹⁰See note 70 *supra* and accompanying text.

⁹¹See text accompanying note 62 *supra*.

⁹²See note 56 *supra* and accompanying text.

⁹³See, e.g., Chicago & N.W. Transp. Co. v. Pedersen, 80 Wis. 2d 566, 259 N.W.2d 316 (1977).

⁹⁴Bickel v. Fairchild, 83 Mich. App. 467, 268 N.W.2d 881 (1978).

⁹⁵Wichelman v. Messner, 250 Minn. 88, 115, 83 N.W.2d 800, 821 (1957).

⁹⁶See Kost v. Foster, 405 Ill. 565, 94 N.E.2d 302 (1950).

mineral interests as well as to future interests.⁹⁷ The above examples concerning marketable title acts could just as easily have used mineral interests instead of vested remainders. Vested remainders were chosen solely for the sake of historical symmetry in comparison with adverse possession color of title statutes.

If viable objections are to be made, they must be made against both marketable title acts and dormant mineral statutes. The same due process question arises in both situations: Has the aggrieved party been deprived of his property without his day in court?⁹⁸ The challenged interest owner has no notice of his duty to re-record. *If knowledge of the duty to re-record could be assumed, it would be difficult to seriously challenge dormant mineral statutes considering the minimal burden re-recording imposes.*⁹⁹ In adverse possession and other statute of limitations situations, the challenge to the aggrieved party's rights is notice of the need for a legal remedy in ejectment. But in the case of the pseudo-statutes of limitation found in marketable title and dormant mineral statutes, the challenge to the title owner's rights does not give the estate owner notice of his need to take affirmative action.

In this regard, it is argued that severed fee owners cannot be held responsible for knowledge of the duties imposed by mineral statutes. Marketable title legislation is far harsher than mineral statutes from the title owner's perspective. Theoretically, a perfect stranger can file regarding a fraudulent transaction and gain good title after forty years.¹⁰⁰ Even knowledge of the law will not help in such a case since the duty to re-record only arises in the presence of a defect in title. Such defects may not be found absent the expense of abstracting every forty years. This argument will be addressed in the next sections.

B. Are Dormant Mineral Statutes Violations of Procedural Due Process?

A title owner cannot reasonably be expected to know of his duty to re-record which gives rise to a vague feeling of injustice whenever a forfeiture is effected by the statute. Mineral acts, therefore, seem arbitrary because they punish title owners for something for which they cannot be held morally responsible. In turn, an understandable prejudice is generated against the statute.

One case centered on the lack of "due notice" as a fatal constitutional defect in dormant mineral statutes. In *Chicago & North-*

⁹⁷See L. SIMES, *supra* note 14, at 240; Note, *supra* note 86, at 31.

⁹⁸See text accompanying notes 75-76 *supra*.

⁹⁹See *Wichelman v. Messner*, 250 Minn. 88, 115, 83 N.W.2d 800, 821 (1957).

¹⁰⁰See note 87 *supra* and accompanying text.

western Transportation Co. v. Pedersen,¹⁰¹ the need for a reasonable notice of re-recording duties was equated with the notice requirements of *Mullane v. Central Hanover Bank & Trust Co.*¹⁰² *Mullane* required that notice be actual, not constructive, whenever possible, taking into account the type of proceedings involved.¹⁰³ The Wisconsin Supreme Court in *Pedersen* held, therefore, that the owners had a constitutional right to notice and a formal judicial hearing.¹⁰⁴ Otherwise, forfeiture due to a lack of re-recording would be constitutionally unacceptable. The court stated:

Implicit in the right to a hearing is adequate notice of the hearing. Personal service is always sufficient notice. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950). Where a person's location is known or easily ascertainable, personal service is also required. *Shroeder v. City of New York*, 317 U.S. 208, 212, 213 (1962). But for, ". . . persons missing or unknown, employment of an indirect and even a probably futile means of notification is all that the situation permits . . ." For such persons publication is adequate notice.¹⁰⁵

Pedersen has been used by the statutes' attackers in a pending Indiana case with considerable success.¹⁰⁶

The requirement of formal personal notice as well as a full judicial hearing in such cases is impractical. To accomplish the

¹⁰¹80 Wis. 2d 566, 259 N.W.2d 316 (1977).

¹⁰²339 U.S. 306 (1950).

¹⁰³*Id.* at 314.

¹⁰⁴80 Wis. 2d at 572, 259 N.W.2d at 319.

¹⁰⁵*Id.*

¹⁰⁶The *Pedersen* holding is pertinent only to the extent the Wisconsin court addressed the mineral statute as a marketable title law as opposed to a tax measure. Apparently, the court also viewed the statute as a property tax and, therefore, drew analogies to the due process procedures required in tax lien foreclosures. See *Devitt v. Milwaukee*, 261 Wis. 276, 52 N.W.2d 872 (1952). Clearly, this analogy is not complete. If the legislature was concerned with the collection of revenue, why did it not provide for a foreclosure proceeding to collect delinquent payments? Why did the severed interest revert to the surface owner? Such a tax is, of course, self-defeating unless the statute is seen in its true role as a marketable title provision with the tax incidental to that purpose. The court took pains, however, to avoid characterizing the statute as a registration measure: "The payment of the fees under sec. 700.-30, Stats. is a tax. The fees raise revenues beyond what is necessary to the administration of the registration scheme." 80 Wis. 2d at 573, 259 N.W.2d at 319. In any event, courts influenced by the *Pedersen* approach have failed to make the distinction between tax foreclosure and registration provisions. See, e.g., *Pond v. Walden*, No. C-78-17 (Gibson Cir. Ct., Ind. July 24, 1978) (applying *Mullane* even though the mineral statute did not contain tax provisions). One wonders, however, whether the Wisconsin court would have reached a different result if the statute had been drafted without the taxation provisions.

legislative goals of dormant mineral statutes, either the government or the possible disseisor would have to be charged with notifying the title owner of his duty to re-record pending forfeiture. If the government were given the responsibility, every mineral title recorded in the state would have to be continuously surveyed for possible expirations of recordations. In addition, a hearing would have to be instituted in each case. In situations involving truly dormant interests, the title owner could not be expected to appear and the proceeding would be little more than a meaningless ritual. Another possibility would be to burden the disseisor with the responsibility of notifying other property owners of their duty to re-record. Yet, to expect the potential disseisor to keep track of a competing owner's dealings in land in the hope for a windfall seems unrealistic. The chance of speculative gain would be so remote and the burden so great that the likelihood of such an effort on the disseisor's part seems slim. In either case, the liabilities assumed in establishing a new "Department of Dormant Minerals" seem to outweigh the benefits derived from mineral statutes limited in the manner that the Wisconsin Supreme Court found necessary. Realistically, dormant mineral statutes in their present form seem to be the least restrictive means to accomplish legitimate legislative goals.

Moreover, if the Wisconsin rule is applied to dormant mineral statutes, notice requirements would have to be extended to marketable title statutes as well as mineral provisions as a matter of principled symmetry. One of the vital advantages of the marketable title acts is that they allow the abstractor to rely on a relatively short chain of title.¹⁰⁷ If notice requirements were introduced, the abstractor would be required to extract a complete chain of title from the records. He would then have to attempt to notify all owners of outstanding defects that their interest would be subject to forfeiture unless they took affirmative action. If all attempts at personal service failed, notice by publication at least would be required. Of course, these attempts at notice, if successful, would breed litigation over the disputed title. One of the purposes of marketable title legislation was to decrease litigation by cutting off stale claims.¹⁰⁸ Dormant mineral provisions and marketable title acts would be less effective methods of accomplishing legislative goals if procedural due process requirements were imposed.

Of course, the mere fact of impracticality is no objection to the recognition of a constitutional right. One cannot deny free speech or other fundamental rights because it may be difficult to accommodate

¹⁰⁷See L. SIMES, *supra* note 14, at 5.

¹⁰⁸See *id.* at 4-6.

the execution of those rights. If the legislature is required to give "due notice" to property owners, then the retroactive enactments discussed above must fail.

Fortunately, a persuasive argument can be made that the Wisconsin court erroneously equated reasonable notice or knowledge of a statutory duty with the notice required by procedural due process. "Reasonable notice," in the sense which the *Pedersen* court employed the term, consists of a man's "reasonable expectations" of the nature of the law and of how fast it should change. The constancy of law encourages men to enter transactions with confidence that their investments will not be endangered by arbitrary or capricious enactments. The requirement of re-recording where no such duty was imposed before seems arbitrary because it disturbs the title owner's "reasonable expectation" of being able to use or *not use* his severed interest as he pleases. Reasonable expectations and their constitutional protections will be discussed later as one factor in the full array of *substantive due process questions*.

If the ideas of procedural due notice and substantive reasonable expectations are equated, the legislature must give formal due process notice of every law which men may not have reasonably anticipated. This proposition is contrary to the old maxim that "ignorance of the law is no excuse." As expressed by the Supreme Court of Iowa: "[E]nactments of our state legislature and publication thereof constitute adequate notification to all concerned as to what they contain."¹⁰⁹ Procedural due process should deal with the initiation of judicial proceedings in which an objective magistrate sits in judgment on competing views of fact and law. Procedural due process standards evolved only to limit such judicial processes in order to promote "fair play and substantial justice,"¹¹⁰ and were not designed to serve as guidelines for the legislative function. These standards break down when employed outside their rightful context. To demand that the legislature pass absolutely no unexpected laws, unless adequate notice is given, would be a fatal curtailment of legislative discretion.

Landowners are generally assumed to be aware of the legal responsibilities concomitant with their ownership. As stated by the United States Supreme Court: "All persons having property located within a state and subject to its dominion must take note of its statutes affecting the control or disposition of such property and of the procedure which they set up for those purposes."¹¹¹ Procedural

¹⁰⁹Presbytery of Southeast Iowa v. Harris, 226 N.W.2d 232, 242 (Iowa) cert. denied, 423 U.S. 830 (1975). See also Wilber Nat'l Bank v. United States, 294 U.S. 120, 124 (1934).

¹¹⁰See International Shoe Co. v. Washington, 326 U.S. 310, 320 (1945).

¹¹¹Anderson Nat'l Bank v. Luckett, 321 U.S. 233, 243 (1944).

due process within the meaning of *Mullane* and notice or knowledge of the law are clearly two different concepts. The conclusion that procedural due process has no application to dormant mineral situations seems inescapable.

C. Do Dormant Mineral Statutes Violate Substantive Due Process?

(1) Has a Governmental "Taking" of Property Occurred or Are Mineral Statutes Merely Regulations of Competing Rights?—*Pedersen* was also concerned with substantive due process.¹¹² The *Pedersen* court held that the transfer or forfeiture under the statute resulted in a governmental taking of property.¹¹³ Since the transfer of any title is a "taking" of sorts, the court concluded that the constitutional criteria of eminent domain proceedings must be satisfied.¹¹⁴ The court declared that not only did the government fail to provide "just compensation," but that the property taken was put to use for private purposes absent even a "quasi-public" justification.¹¹⁵ The following statement of Justice Story is supportive:

Although the sovereign power in free governments may appropriate all property, public as well as private, *for public purposes*, making compensation therefore; yet it has never been understood, at least, never in our republic, that the sovereign power can take the private property of A. and give it to B., by right of "eminent domain;" or, *that it can take it at all, except for public purposes*; or, that it can take it for public purposes without the duty and responsibility of *making compensation for the sacrifice* of private property of one, for the good of the whole.¹¹⁶

Nevertheless, the forfeiture of title is not a taking, but is a regulation of competing rights between the surface owner and the severed title holder. The regulation of rights between individuals has never required the safety measures of eminent domain.¹¹⁷ Unfortunately, the line between a taking and a regulation of rights is unclear.

¹¹²80 Wis. 2d at 574, 259 N.W.2d at 320.

¹¹³*Id.*

¹¹⁴*Id.*

¹¹⁵*Id.*

¹¹⁶Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 420, 442 (1837) (Story, J., dissenting) (emphasis added).

¹¹⁷Goldblatt v. Town of Hempstead, 369 U.S. 590 (1962). The difficulty in drawing the distinction between regulation and taking was recognized: "There is no set formula to determine where regulation ends and taking begins." *Id.* at 594.

Of course, every regulatory measure by the legislature involves the alteration of rights. These alterations may make property more or less valuable. For instance, a change in zoning laws may make a piece of property worthless through limitations on the land's use. Regulatory measures, therefore, are directed solely at the use of property, although use and value are inseparable.¹¹⁸ When a regulatory measure limits such uses and devalues real estate as a result, the statute has summarily deprived the owner of his property and employed it to a public use.¹¹⁹ The similarity to eminent domain proceedings is obvious.

But to hold, because of these similarities, that every regulation of the legislature which alters property values is a taking of property requiring eminent domain safeguards would emasculate legislative power. At some point, an incidental deprivation of property concomitant to the pursuit of legitimate governmental goals graduates from a mere regulation of rights to that of a taking of property. At what point does a regulation become a taking?

Pedersen seemed to embrace the poorly articulated doctrine espoused by the United States Supreme Court in *Penna Coal Co. v. Mahon*:¹²⁰ "When [the deprivation of property] reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act."¹²¹ Apparently, if the value of the property is impaired "a lot," then a taking occurs. Unfortunately, the Supreme Court has established no definitive guidelines regarding the degree of deprivation necessary. In *Goldblatt v. Town of Hempstead*,¹²² mineral interests were effectively extinguished by a town ordinance prohibiting excavation under the water line. Even though no transfer of title occurred, the mineral interests, for all practical purposes, were forfeited to the town's use. Nevertheless, the court found no taking on the part of the municipality.¹²³

Pedersen may be distinguished from *Goldblatt* because an actual transfer of title was executed in the former. In *Goldblatt*, the title owner at least nominally continued in ownership. Hence, the crucial degree of deprivation for the Wisconsin court seemed to be the transfer of nominal ownership from one party to another:

¹¹⁸See *id.* at 592-94.

¹¹⁹*Id.*

¹²⁰260 U.S. 393 (1922).

¹²¹*Id.* at 413.

¹²²369 U.S. 590 (1962).

¹²³*Id.* at 592. The Court explained: "It is an oft-repeated truism that every regulation necessarily speaks as a prohibition. If this ordinance is otherwise a valid exercise of the town's police powers, the fact that it deprives the property of its most beneficial use does not render it unconstitutional." *Id.*

In this case, the plaintiffs' mineral rights will revert to the surface owner if they are not registered or taxes are not paid on them. At least, the plaintiffs must have a hearing where they can question the determination of the register of deeds that the registration has not been done or that the taxes have not been paid.¹²⁴

If the transfer of title is recognized as the crucial degree of deprivation, recording laws designed to protect bona fide purchasers must be considered illegal eminent domain enactments. If the bona fide purchaser records in reliance on the recording laws and without constructive, or actual notice of a former vendee who failed to record his interest, a transfer of title from the negligent former vendee in favor of the buyer takes place in a manner similar to the transfer effected in dormant mineral statutes.¹²⁵ This transfer is usually justified by citing the sovereignty of the state and its license to determine the rights and duties of ownership.¹²⁶ Marketable title acts must also be considered a taking of property under the *Pedersen* view. As seen in the last section,¹²⁷ these acts also effect a forfeiture of title, especially title to future interests once considered fully marketable and secure. All of these statutes, marketable title acts, recording acts, and dormant mineral acts, are retroactive measures which might effect a taking of titles already vested in the sense elaborated by the Wisconsin court.

A more workable rule should be formulated to guide courts as to when a taking occurs. One suggestion might be to limit the doctrine of "just compensation" to governmental acquisitions of specific pieces of property in locations incidental to vital sovereign activity. Eminent domain proceedings should not be required if entire classes of property owners are involved generally throughout the jurisdiction.

This idea complements the scheme of at least one commentator¹²⁸ who emphasizes the role of the government in "just compensation" questions. Where the government plays the role of an impartial arbiter between the rights of competing societal interest groups, eminent domain safeguards ought not to be implemented.¹²⁹ If, on the other hand, the sovereign is acting as a competitor or fellow consumer within the private sector, the increased danger of tyrannical

¹²⁴80 Wis. 2d 566, 572, 259 N.W.2d 316, 319 (1977).

¹²⁵See note 57 *supra* and accompanying text. See also *Bereolos v. Roth*, 74 Ind. App. 100, 124 N.E. 410 (1919); *Blair v. Whittaker*, 31 Ind. App. 664, 69 N.E. 182 (1903).

¹²⁶See authorities cited in note 58 *supra*.

¹²⁷See notes 86-89 *supra* and accompanying text.

¹²⁸See generally *Sax, Takings and the Police Power*, 74 YALE L.J. 36 (1964).

¹²⁹See *id.* at 61-67.

measures justifies the heightened precautions of just compensation when a direct property benefit to the government is involved.¹³⁰ In the case of government as arbiter, a readjustment of competing interests to benefit the whole of society occurs; hence, the sovereign's powers should not be curtailed since no motive for an oppressive initiative is present.¹³¹ The stringent constitutional protections of just compensation should only limit the government if an incentive for oppressive action is present.¹³²

With respect to dormant mineral statutes, the state serves as an impartial arbiter. The statute is employed as a solution to a social problem and the state gains no direct benefit from a transfer of severed estates. Moreover, classes of property are involved, not specific pieces of real estate in particular locations. The conclusion which logically follows is that the rules of eminent domain should not be implemented in dormant mineral situations.

(2) *Do Dormant Mineral Statutes Violate Substantive Due Process?*—When legislatures have found it necessary to enact economic schemes for the public welfare, the present Supreme Court has generally deferred to their judgment.¹³³ Such schemes have long been recognized as legitimate exercises of a state's police power, especially if such a plan is necessary to regulate the use of private property.¹³⁴

*Nebbia v. New York*¹³⁵ first articulated the modern due process limitations on a legislature's efforts at economic regulation:

[A] state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adopted to its purpose. The courts are without authority either to declare such policy, or, when it is declared by the legislature, to override it. If laws passed are seen to have a reasonable relation to a proper legislative purpose, and are neither arbitrary nor discriminatory, the requirements of due process are satisfied¹³⁶

Nebbia limited the review of economic measures to two levels: If a legitimate exercise of the legislative police power is present and a reasonable relation between the operation of a constitutionally ques-

¹³⁰See *id.*

¹³¹*Id.* at 64-67.

¹³²*Id.*

¹³³1 C. ANTIEAU, MODERN CONSTITUTIONAL LAW § 3:2, at 206 (1969).

¹³⁴See generally 2 B. SCHWARTZ, A COMMENTARY ON THE CONSTITUTION OF THE UNITED STATES § 288 (1965).

¹³⁵291 U.S. 502 (1934).

¹³⁶*Id.* at 537.

tioned statute and the exercise of police power is established, then the act withstands substantive due process objections.¹³⁷

The key to understanding this test lies in the following question: What exactly is a reasonable relationship between the exercise of the police power and the operation of a challenged statute? For instance, one legitimate function of the legislature is to assure a big turn-out of voters on election day.¹³⁸ Requiring employers to give their workers a half-day off with pay in order to vote is one method to assure the workers' presence at the polls. On one hand, some would claim that such a scheme was unreasonable or irrational because of the impingement on private rights. The employers never contracted to pay the workers to vote. On the other hand, a lawmaker is not totally unreasonable for believing that such extreme measures are necessary to forward a public interest.

Of course, the word "reasonable" in these contexts is capable of two interpretations. In the first sense, the word includes a *subjective* judgment on the part of the speaker. A value judgment on the questioned statute's wisdom is effectuated. In the second more narrow meaning of the term, unreasonable connotes activity which goes against universally accepted laws of nature.

Modern due process embraces the narrow or objective definition of reasonableness.¹³⁹ Thus, in *Day-Brite Lighting, Inc. v. Missouri*,¹⁴⁰ the Supreme Court upheld the statute requiring time off with pay in order to vote as being a reasonable regulation by the legislature to promote public welfare.¹⁴¹ This view recognizes that the legislature has already balanced the gains and losses from economic legislation and has expressed the will of the people in favor of a public interest.¹⁴² Citizens do not have a constitutionally protected liberty interest in property;¹⁴³ hence, unlike impingements on liberty interests such as free speech, the constitutional presumption is in favor of a challenged statute which abridges only property rights.¹⁴⁴

¹³⁷See 2 B. SCHWARTZ, *supra* note 134, at 57.

¹³⁸See, e.g., *Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421 (1952).

¹³⁹See 2 B. SCHWARTZ, *supra* note 134, § 276. This idea rejects the role of the Court as a super-legislature. See *Jay Burns Baking Co. v. Bryan*, 264 U.S. 504, 534 (1924) (Brandeis, J., dissenting). The idea is sometimes used in opinions dealing with the commerce clause. See *Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945) (Black, J., dissenting). The gist of modern due process centers upon whether the Supreme Court will determine the reasonableness of an act from the perspective of the Justices themselves or from the views of a reasonable legislator.

¹⁴⁰342 U.S. 421 (1952).

¹⁴¹*Id.* at 424-25.

¹⁴²See 2 B. SCHWARTZ, *supra* note 134, § 276.

¹⁴³See *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937).

¹⁴⁴See *Village of Belle Terre v. Boraas*, 416 U.S. 1 (1974); cf. *San Antonio School Dist. v. Rodriguez*, 411 U.S. 1 (1973) (dealing with state educational system).

The burden of proving the lack of a rational connection between police power and the questioned enactments rests squarely on the attacking party: "[B]y their very nature such inquiries, where the legislative judgment is drawn in question, must be restricted to the issue whether *any state of facts* either known or *which could reasonably be assumed* affords support for [the legislative judgment]."¹⁴⁵ The modern approach also prohibits a judgment regarding the wisdom or value of the suspect legislation: "[I]f our recent cases mean anything, they leave debatable issues as respects business, economic, and social affairs to legislative decision."¹⁴⁶

If the modern due process test is properly applied to dormant mineral acts, there is little doubt as to mineral statutes' constitutionality. For instance, the only practical difference between recording statutes and mineral acts lies in the former being primarily for the protection of third parties against fraud,¹⁴⁷ while the latter addresses such economic woes as the energy shortage, marketability of land, and competing rights between private ownerships.¹⁴⁸ Both enactments undeniably address legitimate objects of police power. Too many commentators have pointed out the need for dormant mineral provisions to permit the courts to characterize the statutory schemes as unreasonable or irrational.¹⁴⁹ One may disagree with these enactments by asserting that security of ownership and the value of private interests outweigh the public needs for marketable titles and energy. But, as seen above, debatable questions must be left to the legislature. The Supreme Court stated in *Day-Brite*: "Our recent decisions make plain that we do not sit as a super-legislature to weigh the wisdom of legislation nor to decide whether the policy which it expresses offends the public welfare."¹⁵⁰ In other words, one judge should not be able to strike down an entire legislative effort merely because he prefers private property over public policy.

Unfortunately, while the above test clearly applies to prospective measures, it is uncertain whether it also applies to retroactive legislation. A higher level of review has traditionally measured the constitutionality of retroactive enactments.¹⁵¹ Three tests have been forwarded for analyzing the due process requirements for retro-

¹⁴⁵United States v. Carolene Prods. Co., 304 U.S. 144, 154 (1938) (emphasis added).

¹⁴⁶*Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421, 425 (1952).

¹⁴⁷See *American Land Co. v. Zeiss*, 219 U.S. 47, 61-62 (1911); *Jackson v. Lamphire*, 28 U.S. (3 Pet.) 281, 289 (1830).

¹⁴⁸See Polston, *supra* note 1, at 73-78.

¹⁴⁹See notes 3 & 14 *supra*.

¹⁵⁰342 U.S. at 423 (1952). See also *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483 (1955).

¹⁵¹See generally Smith, *Retroactive Laws and Vested Rights* (pts. 1 & 2), 5 TEX. L. REV. 231, 6 TEX. L. REV. 409 (1927-1928). See also P. BASYE, *supra* note 6, § 213.

active statutes: (1) A retroactive law is constitutional as long as it does not disturb vested rights,¹⁵² (2) the court must balance "the nature and strength of the public interest served by the statute, the extent to which the statute modifies or abrogates the asserted preenactment right, and the nature of the right which the statute alters,"¹⁵³ and (3) a retroactive law may not upset the reasonable expectations of the parties at the time they entered the preenactment transaction upon which the challenged law directly operates.¹⁵⁴ The vital questions are whether one or all three of the above tests apply to retroactive measures or whether the modern due process test applies.

The vested rights doctrine as a dispositive constitutional determination has long been rejected by the better authorities. In *City of El Paso v. Simmons*,¹⁵⁵ the Supreme Court stated: "[D]ecisions dating from *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398 have not placed critical reliance on the distinction between obligation [or right] and remedy."¹⁵⁶ The Court then questioned the soundness of the vested rights approach.¹⁵⁷ The prohibition against impairments of vested interests is vitally intertwined with the primary exception to the rule, namely, the legislative power to alter remedies.¹⁵⁸ In admitting that rights and remedies are not easily separated, the doctrine suffers a fatal defect and should, therefore, be expressly renounced. Moreover, the doctrine has generated more confusion than clarity because of its lack of predictability. "A court lays down the rule that vested rights are protected, but rights that are not vested may be taken away. The legislature, then, cures a defective conveyance and deprives the grantor of what theretofore . . . was a vested right."¹⁵⁹ "[I]t has long been recognized that the term 'vested right' is conclusory—a right is vested when it has been so far perfected that it cannot be taken away by statute."¹⁶⁰

Professor Hochman, a proponent of the second test, concluded that the Supreme Court balanced three factors to determine whether the questioned law overstepped constitutional limitations: "[T]he nature and strength of the public interest served by the statute, the extent to which the statute modifies or abrogates the

¹⁵²See notes 29-35 *supra* and accompanying text.

¹⁵³Hochman, *The Supreme Court and The Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 697 (1960).

¹⁵⁴See Smith, *supra* note 151.

¹⁵⁵379 U.S. 497, 506 n.8 (1965).

¹⁵⁶*Id.* at 506-08.

¹⁵⁷See *id.*

¹⁵⁸See *id.*

¹⁵⁹Smith, *supra* note 151, 6 TEX. L. REV. at 426.

¹⁶⁰Hochman, *supra* note 153, at 696.

asserted preenactment right, and the nature of the right which the statute alters."¹⁶¹ One can make an excellent argument supporting dormant mineral provisions in two of the three Hochman categories. Important public interests are served by the statutes—marketable titles, energy exploration, and the effective utilization of land. The degree of abridgement of the preenactment rights is slight because of the opportunity to preserve the interest by re-recording. This burden seems especially small when one recognizes that due notice of the duties concomitant with land ownership are assumed.¹⁶² That the statutes disrupt "reasonable expectations" makes this final inquiry a close question.

One would think that these factors were considered and balanced by the legislatures when they enacted dormant mineral statutes since Hochman's guidelines involve no more than a consideration of the public advantages and private disadvantages of any new statutory scheme. In weighing the above factors, is not the court turning into a super-legislature? Does not the Hochman balancing act conflict with the modern due process policy against judging the value and the wisdom of legislation? The following caveat was given by the Supreme Court in *Williamson v. Lee Optical of Oklahoma, Inc.*:¹⁶³ "But it is for the legislature, not the courts, to balance the advantages and disadvantages of the new requirement."¹⁶⁴

While Hochman concludes that the Court will employ a higher level of review when dealing with retrospective enactments, there seems to be no clear justification for this distinction between prospective and retrospective laws. Prospective laws may be just as harsh as retrospective ones.¹⁶⁵ Moreover, any new statutory scheme in some way affects interests already vested. If the legislature makes a certain type of contract illegal in the future, it limits the ways in which property might have been utilized and, hence, impairs property rights. If a zoning law is passed prohibiting uses not already established, even this restriction obviously deflates the value of vested interests in real estate.

The Supreme Court has not unequivocally held that the modern due process test applies to retrospective enactments, although several cases did utilize that test in retrospective situations.¹⁶⁶ The Supreme Court's most recent decision, however, appears to favor the modern view of due process.

¹⁶¹*Id.* at 697.

¹⁶²See notes 109 & 111 *supra* and accompanying text.

¹⁶³348 U.S. 483 (1955).

¹⁶⁴*Id.* at 487.

¹⁶⁵See, e.g., *Goldblatt v. Town of Hempstead*, 369 U.S. 590 (1962); *Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421 (1952).

¹⁶⁶See, e.g., *Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32 (1940).

In *Usery v. Turner Elkhorn Mining Co.*,¹⁶⁷ plaintiff mine owners challenged the constitutionality of the Black Lung Act, which required them to pay benefits to inflicted workers who had retired prior to the effective date of the Act. Plaintiffs argued that the past transactions with employees could not now become subject to added duties and liabilities. The labor received from the mine workers had, they argued, become vested property rights constitutionally sheltered from statutory impositions of added liability. The court dismissed plaintiffs' objections:

We are unwilling to assess the wisdom of Congress' chosen scheme by examining the degree to which the "cost-savings" enjoyed by operators in the pre-enactment period produced "excess" profits, or the degree to which the retrospective liability imposed on the early operators can now be passed onto the consumer. *It is enough to say that the Act approaches the problem of cost spreading rationally . . .*¹⁶⁸

Usery also held that the burden of establishing the absence of a rational connection between the operation of the statute and the forwarding of the public welfare is upon the party challenging the enactment.¹⁶⁹

Even though the Court applied the modern due process test in its refusal to balance the interests involved,¹⁷⁰ the Court was equivocal as to whether such a test would be appropriate in every situation: "It does not follow, however, that what Congress can legislate prospectively it can legislate retrospectively. The retrospective aspects of legislation, as well as prospective aspects, must meet the test of due process, and the justification for the latter may not suffice for the former."¹⁷¹ Assuming that the Court meant what it said, one wonders why, in *Usery*, it applied the modern due process test to a retroactive statute. If the Court consistently applied such a test, it would allow Congress to do that which the Court has forbidden, namely, to enact retrospectively that which may be enacted prospectively.

¹⁶⁷428 U.S. 1 (1976).

¹⁶⁸*Id.* at 18-19 (emphasis added).

¹⁶⁹*Id.* at 15.

¹⁷⁰See J. NOWAK, R. ROTUNDA & J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 433 (1978) [hereinafter cited as J. NOWAK]. The authors concluded: "Justice Marshall was unwilling to weigh competing interests to assess the constitutionality of the legislation. He deferred to the legislature judgment and refused 'to assess the wisdom of Congress' chosen scheme.'" *Id.* (quoting *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. at 16).

¹⁷¹428 U.S. at 16-17.

Usery suggests that there may be certain categories of retroactive legislation which must satisfy more rigorous due process hurdles. This proposition is supported by the Court's reference to *Railroad Retirement Board v. Alton Railroad*.¹⁷² That case involved a fact situation similar to *Usery*. Congress had enacted a law requiring railroads to establish pension funds not only for all railway workers employed at the time the provision was enacted, but also for all workers employed a year before the effective date of the act. This pension provision bears a striking similarity to the black lung laws attacked in *Usery*. Both statutes may be said to take one person's property and give it to another since the property of railroad and mining interests were to be given to their former workers. The enactment added liabilities to employment contracts which had already been consummated and had risen to the level of a property interest. Nevertheless, the Court held the retroactive deprivation in *Alton* to be constitutionally deficient.¹⁷³

The Supreme Court attempted to distinguish *Usery* from *Alton* in order to avoid overruling the latter: "The point of black lung benefit provisions is not simply to increase or supplement a former employee's salary to meet his generalized need for funds."¹⁷⁴ In other words, because *Usery* involved a congressional attempt to curtail black lung while *Alton* involved efforts to insure material security for the elderly in the form of pensions, the Court was justified in *Alton* in its implementation of a higher level of review. Hence, the conclusion seems to follow that, in the category of pension plans, the Court may balance the interests, i.e., a Hochman analysis or a justified expectation test. The Court also intimated that the same approach may be appropriate in tax cases.¹⁷⁵ On the other hand, when reviewing black lung provisions, "[i]t is enough to say that the Act approaches the problem of cost spreading rationally"¹⁷⁶

The above distinction seems feeble. One possible explanation is that the Court engaged in a balancing process to decide which level of review would be appropriate. If the need for the legislation is great when compared to the private interest impaired, as in the case of black lung, the Court perhaps will employ a low level of review. If the social good served pales in comparison to the private right impaired, then the Court will balance the interests in a Hochman-type manner. In applying the former test, as in *Usery*, the Court would have to balance the interests to determine whether it will balance

¹⁷²295 U.S. 330 (1934), cited in *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. at 19.

¹⁷³295 U.S. at 350.

¹⁷⁴428 U.S. at 19.

¹⁷⁵*Id.* at 17 n.16.

¹⁷⁶*Id.* at 19.

the interests at a higher level of review. This process seems overly cumbersome.

To avoid the result above, one cannot place much credence in the Court's dicta. The decision as a whole favors the low level of review found in modern due process. Any other result might contradict the Court's criticism of becoming a "super-legislature" and usurping the role of the lawmakers.¹⁷⁷ In addition, if the Court had been too broad or definite in its discussion of the appropriate test in retroactive situations, it might have disturbed well-established precedent in areas which have traditionally received special treatment, such as in tax cases.¹⁷⁸ Taking the above reservations into consideration, the expectation that the Court will utilize the method implemented in *Usery* to test the due process violations in most retroactive situations seems sound.

Finally, the "reasonable expectation" test provides that no law is valid which negates the reasonable expectations of the parties at the time they entered into the preenactment transaction.¹⁷⁹ Since the severed mineral holders never expected a re-recording or use requirement at the time they acquired title, a forfeiture due to a failure to re-record would defeat their reasonable expectations. The expectation test would, therefore, demand the downfall of mineral statutes. Indeed, this factor of "reliance" or "surprise" in tax cases has played a major role.¹⁸⁰ As one authority stated: "[I]f the Court is convinced that the taxpayer had reasonable notice that a certain type of property transfer would be taxed, the Justices will uphold the measure despite its retroactive effect."¹⁸¹

While the concept of "reasonable expectations," "reliance," or "surprise," may be significant in tax cases, to say that it is dispositive in every case of an unexpected law would be an overstatement. As the Supreme Court stated in *Usery*: "[O]ur cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations."¹⁸²

Serious problems have been shown with the Hochman test, the vested rights doctrine, and the expectation test. Also, in the most recent case dealing with the problem, the Supreme Court expressed a preference for an application of the modern due process test. For these reasons, no viable due process objections may be leveled against dormant mineral statutes. At the highest level of review,

¹⁷⁷See note 150 *supra* and accompanying text.

¹⁷⁸See, e.g., *Welch v. Henry*, 305 U.S. 134 (1938).

¹⁷⁹See *Smith*, *supra* note 151, 6 TEX. L. REV. at 418.

¹⁸⁰See *Welch v. Henry*, 305 U.S. 134 (1938).

¹⁸¹J. NOWAK, *supra* note 170, at 431.

¹⁸²428 U.S. at 16.

the Hochman test may force the advocates to "balance" the interests involved. Yet, even with the balancing test, it has been shown that the chance of sustaining these statutes is good. Also, if the modern due process test in *Usery* is applied, as seems likely, dormant mineral statutes would be exonerated.

D. Do Dormant Mineral Enactments Violate the Contract Clause?

Until recently, one may have plausibly asserted that the contract clause had been absorbed into due process law. Indeed, this position made sense. On one hand, a contract was considered a type of "property" which deserved as much protection by the fourteenth amendment as any other incident of ownership.¹⁸³ On the other hand, the contract clause with its traditionally wide interpretation extended not just to contracts per se, but to the fruits of contracts and anything resembling legally binding agreements.¹⁸⁴ "Moreover, several cases had indicated that the standard of reasonableness under the contract clause is the same as that utilized in determining the validity of retrospective legislation under the due process clauses of the fifth and fourteenth amendments."¹⁸⁵ The Court has

¹⁸³See, e.g., *Addison v. Huron Stevedoring Corp.*, 204 F.2d 88 (2d Cir.), cert. denied, 346 U.S. 877 (1953).

¹⁸⁴Justice Story recognized a very wide range of property to which the contract clause applied:

A contract is either executory or executed. An executory contract is one in which a party binds himself to do, or not to do, a particular thing. An executed contract is one in which the object of the contract is performed. This differs in nothing from a grant; for a contract executed conveys a *chance in possession*; a contract executory conveys only a *chance in action*. Since, then, a grant is in fact a contract executed, the obligation of which continues, and since the Constitution uses the general term, *contract*, without distinguishing between those which are executory and those which are executed, it must be construed to comprehend the former as well as the latter. A State law, therefore, annulling conveyances between individuals, and declaring that the grantors should stand seized of their former estates, notwithstanding those grants, would be as repugnant to the Constitution, as a State law discharging the vendors from the obligation of executing their contracts of sale by conveyances. It would be strange, indeed, if a contract to convey were secured by the Constitution, while an absolute conveyance remained unprotected; that the contract, while executory, was obligatory, but when executed, might be avoided.

2 J. STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1376, at 247-48 (5th ed. 1891) (footnotes omitted). Justice Story would extend the contract clause to "executed" contracts—meaning that the fruits of an agreement, or the property rights received as a result of the contract's consummation, would be protected. Essentially, this application could include all property.

¹⁸⁵Hochman, *supra* note 153, at 695 (citing *Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32 (1940)).

never been slow to identify the two clauses: "The restraint imposed upon legislation by the due process of the two amendments is the same."¹⁸⁶

Considering the close relationship between the contract and due process clauses, one might have claimed that the contract clause was a superfluous appendage to the due process clause. This conclusion was supported by *City of El Paso v. Simmons*.¹⁸⁷ In *Simmons*, public land in Texas was sold by the state to raise revenue. The mortgage given by the state allowed the mortgagor to reinstate his claim after default by payment of the accrued interest. This right to reclaim the land was unlimited, provided that the interests of third parties had not intervened. The statute in question, however, retroactively narrowed this right to only five years after the first default in mortgage payments. The Court upheld the enactment on the ground that the state interest, balanced against the private right impaired, justified the Texas provision.¹⁸⁸ This result seems similar if not identical to the due process balancing test forwarded by Hochman.

Despite these cases, one court employed the contract clause to strike down a dormant mineral statute. The Michigan Court of Appeals, in *Bickel v. Fairchild*,¹⁸⁹ adopted a balancing test to determine whether the statute passed the rigors of the contract clause.¹⁹⁰ Rejecting the idea that the government is helpless to serve the public welfare if such service would encroach on vested rights, the court asserted that a statutory impairment to contract rights may be justified when the public interest forwarded outweighs the private rights deprived.¹⁹¹ On one side of the scale, public policy involved the energy shortages, marketability of titles, and efficient utilization of land. On the other side, private parties were robbed of security of ownership and the justified expectations of the severed estate's owner. Using experienced judicial judgment, the *Bickel* court concluded that the balance tipped in favor of private ownership and vetoed the judgments of legislators, claiming that the enactment failed the test of the contract clause.¹⁹²

Bickel depended heavily on *United States Trust Co. v. New Jersey*.¹⁹³ *United States Trust* could be viewed as breathing new life

¹⁸⁶Heiner v. Donnon, 285 U.S. 312, 326 (1932).

¹⁸⁷379 U.S. 497 (1965).

¹⁸⁸*Id.* at 508.

¹⁸⁹83 Mich. App. 467, 268 N.W.2d 881 (1978).

¹⁹⁰*Id.* at 471-72, 268 N.W.2d at 883-84.

¹⁹¹*Id.*

¹⁹²*Id.* at 472, 268 N.W.2d at 884.

¹⁹³431 U.S. 1 (1977), noted in *Bickel v. Fairchild*, 83 Mich. App. at 471, 268 N.W.2d at 883. The court also relied on *City of El Paso v. Simmons*, 379 U.S. 497 (1965); *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934).

into the contract clause and somehow separating that clause from due process by employing a higher level of review than that applied to due process in *Usery*.¹⁹⁴ Nevertheless, even a cursory reading of *United States Trust* reveals that it seems to be an exception to a general rule of *complete deference*. The Court stated: "In applying this standard [a balance of interests test], however, *complete deference* to a legislative assessment of *reasonableness* and *necessity* is not appropriate because the state's self-interest is at stake."¹⁹⁵ The state was attempting to break its own contractual obligations. Moreover, the above statement seems to imply that *in all other situations* complete deference would be appropriate. Thus, the courts should refrain from balancing interests and should refuse to pass on the value or wisdom of the legislation in dormant mineral situations. This interpretation would conform to the holding in *Usery* by applying the modern due process deference even if the contract clause is involved.

A very recent Supreme Court decision, however, gives the holding in *Bickel* a sound precedential basis. In *Allied Structural Steel Co. v. Spannaus*,¹⁹⁶ the Court struck down a Minnesota pension act.¹⁹⁷ The act prohibited the forfeiture of pension benefits of individuals employed more than ten years by private employers of more than one hundred persons. This prohibition was activated only if the pension would be lost because of a plant closure or termination of the pension plan. The employer-plaintiff claimed that the act impaired the collective bargaining contract and argued that the statute violated the contract clause.

Justice Stewart stated that if the contract clause "is to retain any meaning at all . . . it must be understood to impose *some* limits upon the power of a state to abridge existing contractual relationships."¹⁹⁸ He employed several factors to determine whether prohibited impairments of contractual obligations had occurred. First, the severity of impairment will dictate the degree of review. "Severe impairment . . . will push the inquiry to a careful examination of the *nature and purpose* of the state legislation."¹⁹⁹ If a severe impairment is found, other factors may be considered: (1) Whether the statute has an extremely narrow focus affecting only a few people adversely, (2) whether the state traditionally regulates the area in which the contract is involved or whether the state has attempted a

¹⁹⁴See generally Note, *Revival of The Contract Clause*, 39 OHIO ST. B.J. 195 (1978).

¹⁹⁵431 U.S. at 25.

¹⁹⁶98 S. Ct. 2716 (1978).

¹⁹⁷*Id.* at 2726.

¹⁹⁸*Id.* at 2721.

¹⁹⁹*Id.* at 2723 (emphasis added).

totally new type of regulation, (3) whether the questioned provision deals with pervasive economic problems, (4) whether the statute upsets otherwise settled expectations of the contracting parties, (5) whether the statute permanently or temporarily alters contractual relationships, and (6) whether the statute attempted to remedy an emergency.²⁰⁰ These factors are considered in the balancing of private interests against public goals. This analysis is similar to the approach taken by the *Bickel* court.

Assuming that *Spannaus* represents the latest Supreme Court perspective on the contract clause, *Bickel* seems on solid constitutional ground. *Bickel* involved the total abrogation of a gas lease entered into by the parties after the expiration of the re-recording grace period and the forfeiture in favor of the disseisor had occurred. Yet, the presence of such a "lease" or "contract" would not have been necessary for an application of the contract clause. The historically wide application of that clause applies to the "fruits" of a contract²⁰¹ and the use or nonuse of the severed interest once received by a new title owner from the land purchase contract is certainly a "fruit" of that contract.

One wonders, however, in the absence of an *executory contract* whether a severe impairment could be found. Some limit must be placed on the situations in which the contract clause can be employed. If that clause extends to *all* the fruits of a contract, it becomes essentially applicable to *all* property. Practically all ownership in a modern society is a product of contract law. Again, one is faced with the problem of either the contract clause encompassing due process analysis or *due process* encompassing the contract clause. When the *Spannaus* Court attempted to give the contract clause meaning, it did not intend, as a result, the due process clause to become merely an appendage of contract law.

If the Supreme Court's purpose is to make the contract clause a meaningful constitutional entity, the situations in which the clause is applicable must be clearly delineated. A severe impairment of a property interest should not necessarily be a severe impairment of a contract. After all, an expressed constitutional preference for contracts was provided by the founding fathers. No similar provision may be found for property. This distinction indicates that the policy considerations in reviewing laws which impair contracts as opposed to enactments abridging property rights are different. Considering the deference owed in modern due process to the legislature, is it not inconsistent to defer to the judgment of the legislature on a point under due process review and then, because the property in ques-

²⁰⁰*Id.* at 2725-26.

²⁰¹See note 188 *supra* and accompanying text.

tion was at one time remotely connected with a contract, abandon that deference by establishing new due process dictates under the guise of the contract clause?

For instance, would the results in the following cases change if the contract clause had been applied? In *Goldblatt v. Town of Hempstead*,²⁰² the city stopped a mining operation by prohibiting excavation beneath the water line within the city limits. The statute was a safety measure. Even though the statute retroactively and severely impaired a property interest, the court found no due process problems and upheld its enactment.²⁰³ If a broad application of the contract clause is allowed, the clause could have been pertinent to *Goldblatt*. The right to excavate under the water line was one of the objects of the contract when the fee simple was first acquired. Moreover, the contracting parties had "settled expectations" that excavation rights would remain intact as long as the fee simple absolute was a viable interest. Another example may be zoning laws. The right to an unlimited use of real estate is one of the fruits of a contract. If a purchaser buys property for the purpose of industrial development, and if zoning laws subsequently prohibit such development, should the problem be analyzed as an impairment of a contract or a due process problem?²⁰⁴

As Justice Brennan's dissent in *Spannaus* points out, the contract clause was never meant to protect "all contract based expectations."²⁰⁵ Indeed, the founding fathers addressed only the immediate social evil of debtor relief laws.²⁰⁶ But to limit the contract clause only to debtor relief situations would be to ignore subsequent historical developments.²⁰⁷ There are certain features of debtor relief laws, however, that may provide some principled limits to the contract clause and prevent the clause from incorporating due process protections of property.

First, a debtor relief law involves executory contracts. The contract itself is property in the expectation of the performance of duties on both sides. Once performance on both sides has been consummated, the contract rights are no longer viable. Such rights are then recognized as general property interests free of contractual stigmas. At that point, due process should be the sole criterion of constitutionality.

²⁰²369 U.S. 590 (1962).

²⁰³*Id.* at 594-96.

²⁰⁴See *Moore v. City of East Cleveland*, 431 U.S. 494, 513-21 (1977) (Stevens, J., concurring). See also *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).

²⁰⁵98 S. Ct. at 2729 (Brennan, J., dissenting).

²⁰⁶*Id.* (Brennan, J., dissenting).

²⁰⁷See generally Hale, *The Supreme Court and The Contract Clause: I*, 57 HARV. L. REV. 512, 514-16 (1944).

Second, debtor relief laws make a once *viable contractual obligation illegal*.²⁰⁸ Hence, debtor relief provisions present the problem of retroactivity in its classic form. While the contract or gas lease in *Bickel* was executory, one cannot as easily say that the lease was a viable and legal contract made illegal by Michigan's dormant mineral law. The severed estate in *Bickel* was first acquired in 1944. The Michigan statute went into effect in 1963. The statute requires re-recording for interests not "used" within twenty years.²⁰⁹ The use requirement, as with most dormant statutes, includes a sale, lease, mortgage, or any transfer of the severed interest by a recorded instrument.²¹⁰ The twenty-year period for the interest in *Bickel* expired in 1964. The act has a three-year grace period.²¹¹ Hence, if the statute was constitutionally viable, the severed interest's title owner forfeited his interest to the surface owner as of 1966. The contract supposedly impaired by the mineral statute was not entered into until 1973. Therefore, the question in *Bickel* was not one of an impairment of a contract, despite the court's assertions.²¹² Given that the statute could not be objected to on due process grounds, the gas lease conveyed nothing in 1973 since the forfeiture had already been effected. Logically, a void contract cannot be impaired. The real issue was whether the forfeiture in 1966 was constitutional and that issue is a question of due process.

When a dormant mineral statute recognizes a transaction or transfer involving the severed interest as a "use," thereby preserving title for the record holder, the contract clause should never come into play. If a gas or other mineral lease is entered into before the re-recording period expires, the contractual transaction renews title for another twenty years. On the other hand, if a lease is entered into after the re-recording period expires, the forfeiture would have already occurred in favor of the disseisor-surface owner. Such a lease would be void and therefore could not be impaired. In other words, the lease would not be abridged by the statute in a retroactive manner since the operation of the dormant mineral law—the forfeiture—occurs before the lease is executed.

Even if courts in the future give the contract clause a wide application, *Spannaus* lists several vital factors not considered in *Bickel*. First, dormant mineral statutes involve areas of traditional legislative regulation. Comparisons between mineral statutes, recording acts, and marketable title legislation have made this clear. To reject dormant mineral statutes would be to disturb pervasive and

²⁰⁸See 98 S. Ct. at 2728-29 (Brennan, J., dissenting).

²⁰⁹MICH. COMP. LAWS § 554.291 (1967).

²¹⁰*Id.*

²¹¹*Id.*

²¹²83 Mich. App. at 473, 268 N.W.2d at 884.

long standing legislative attempts to improve conveyance law. Second, one questions how justified the expectation of the severed estate owner is if he asserts that after twenty years of nonuse, his title should be secure. Even a layman feels that an object of ownership is somehow "less owned" if its possessor ignores it for twenty years. This conclusion may be reached even without being familiar with analogies to adverse possession. Third, the statute affects a wide class of owners. These include oil companies with powerful lobbying voices as well as small speculators and surface estate owners. Finally, dormant statutes address pervasive economic illnesses including the marketability of land and the energy crisis.

Because of the lack of an executory or any other viable contract in these cases and because, alternatively, mineral enactments can easily be justified under the criteria set forth in *Spannaus*,²¹³ one must conclude that the contract clause does not present a constitutional bar to dormant mineral statutes.

IV. A SUMMARY OF THE ISSUES—COMPARISONS BETWEEN ANTI-REVERTER STATUTES AND DORMANT MINERAL ACTS

The best reasoned case concerning retroactive land statutes is *Presbytery of Southeast Iowa v. Harris*.²¹⁴ A short look at the case may serve to summarize some of the issues presented in this Note. *Harris* addressed the problem of the constitutionality of anti-reverter acts. These acts usually require re-recording of all reverter interests on record in order to preserve them past a designated time period. Both anti-reverter acts and dormant mineral statutes are designed to increase the marketability of land.²¹⁵

While the constitutionality of anti-reverter provisions is now clearly settled,²¹⁶ it was seriously questioned at one time.²¹⁷ The attackers of the reverter statute made four familiar objections: (1) That the act was an unconstitutional impairment of contract, (2) that it authorizes a divestment in violation of substantive due process, (3) that it was unreasonably vague, and (4) that the statute violated procedural due process in affording no reasonable notice to reverter owners of their duty to record.²¹⁸

The similarities between this type of reverter statute and dor-

²¹³98 S. Ct. at 2725-26. See text accompanying note 200 *supra*.

²¹⁴226 N.W.2d 232 (Iowa), *cert. denied*, 423 U.S. 830 (1975).

²¹⁵See Polston, *supra* note 1, at 78.

²¹⁶See, e.g., *Hiddleston v. Nebraska Jewish Educ. Soc'y*, 186 Neb. 786, 186 N.W.2d 904 (1971). For an excellent summary of the problems in this area, see Note, *Retroactive Termination of Burdens on Land Use*, 65 COLUM. L. REV. 1272 (1965).

²¹⁷See *Board of Educ. of Cent. School Dist. v. Miles*, 15 N.Y.2d 364, 207 N.E.2d 181, 259 N.Y.S.2d 129 (1965) (holding unconstitutional New York's anti-reverter statute).

²¹⁸226 N.W.2d at 234.

mant mineral enactments are apparent. Reverter statutes were justified in part as statutes of limitation, just as the proponents of dormant mineral statutes attempt to justify mineral enactments. Indeed, the court in *Harris* mentioned this point as one of the many arguments used to sustain the reverter act.²¹⁹

This reference to reverter enactments as statutes of limitation generated enough confusion to allow the dissenter to build his argument around the point of remedies: "As applied, [the statute] would have required defendants to assert their 'claim' before it accrued and operates potentially to bar their remedy before the 'right' to enforce it matured."²²⁰ By claiming that the statute operated as a "pseudo-statute of limitation,"²²¹ the dissent dismissed the possibility that the statute was within the bounds of substantive due process. The dissent never addressed the due process question of whether the challenged enactment was a legitimate exercise of police power to which the act's operation had some kind of rational connection.²²²

The statute of limitations point was not, however, pivotal to the holding. Instead, the fact that the act allowed a re-recording was vital: "'But it is well established that a statute limiting the time for assertion even of *preexisting property or contract rights* is not unconstitutional provided it allows a reasonable time after its enactment for the assertion of those rights.'"²²³ While it is difficult to define a "preexisting property or contract right," the statement seems to rebut the argument that the anti-reverter statute is actually a pseudo-statute of limitation. In other words, the *Harris* court embraced the principle that a recording may be effective only for a limited period of time.²²⁴ The legislature may then require re-recording on penalty of an instant forfeiture of substantial property rights, regardless of the fact that such a requirement was once condemned as a pseudo-statute of limitation.²²⁵

Moreover, the court accurately treated the problem of reverter statutes as a substantive due process question.²²⁶ The real issue, thus, becomes one of whether the re-recording requirement was capricious or arbitrary in light of the public welfare served and the private interest impinged. Unfortunately, the court explicitly²²⁷ used

²¹⁹*Id.* at 237.

²²⁰*Id.* at 244 (Rees, J., dissenting).

²²¹See notes 70-75 *supra* and accompanying text.

²²²See 226 N.W.2d at 244 (Rees, J., dissenting).

²²³*Id.* at 241 (quoting *Selectman of Nahant v. United States*, 293 F. Supp. 1076, 1078 (D. Mass. 1968) (emphasis added)).

²²⁴226 N.W.2d at 232. See also Marshall, *Reforming Conveyancing Procedure*, 44 IOWA L. REV. 75, 80 (1958).

²²⁵226 N.W.2d at 241.

²²⁶*Id.* at 242.

²²⁷*Id.*

a Hochman balancing test and, therefore, addressed the issue in a manner similar to the court in *Bickel*. Today, considering the recent *Usery* decision, a lower level of review may be appropriate.²²⁸

On one side, the *Harris* court saw a tremendous public service performed by reverter statutes in the name of marketability. On the other, only an insubstantial property interest was impaired. The scales of due process were tipped in favor of the statute.²²⁹ Dormant mineral statutes should also be sustained through a similar balance.

Finally, *Harris* also involved a procedural due process issue. In a manner similar to the opponents of mineral statutes, the dissent claimed that the owners of reverters were not given sufficient due notice of their duty to re-record and that, therefore, the statute effected a forfeiture absent procedural due notice.²³⁰ The dissent buttressed this argument by noting the Supreme Court's increased concern with due notice in garnishment situations.²³¹ Citing *Fuentes v. Shevin*,²³² he pointed to the irony of placing such strict procedural standards in cases concerning collection of debt and garnishment on one side, while on the other, ignoring the need of the layman to be notified of the unexpected legislative caprice that could work to the average property owner's detriment.²³³

The majority dismissed the due notice objection, however, by holding that the reverter statute itself, even as newly passed by the legislature, was sufficient notice to the damaged reverter owner of his duty to re-record: "[E]nactments of our state legislature and publication thereof constitute adequate notification to all concerned as to what they contain."²³⁴

The judiciary should shed the mistakes of the past and begin to address questions concerning retroactive land statutes as clearly and accurately as the *Harris* court. The hard problems of the present cannot be solved by the mechanical distinctions of vested rights, nor can they withstand an incomplete analysis. The legislature has as much discretion in the area of real property as in the other realms of due process. These statutes should not be subjected to any special tests, such as Hochman's balance or the reasonable expectations test, to determine their validity. Considering the serious problems of marketability and the energy crisis, dormant mineral statutes and other similar retroactive measures should be sustained.

GREGORY BUBALO

²²⁸See notes 167-178 *supra* and accompanying text.

²²⁹See 226 N.W.2d at 243.

²³⁰226 N.W.2d at 244 (Rees, J., dissenting).

²³¹*Id.*

²³²407 U.S. 67 (1972).

²³³See 226 N.W.2d at 244.

²³⁴*Id.* at 242.

Prior Statements as Substantive Evidence in Indiana

I. INTRODUCTION

In general, prior statements are a declarant's statements concerning the same subject matter to which he later testifies in court. Prior statements may be either consistent or inconsistent with the declarant's later in-court testimony.

The extent to which prior statements are admissible as *substantive* evidence is unsettled in Indiana. In *Patterson v. State*,¹ the Indiana Supreme Court overruled previous Indiana decisions and held that some prior statements are admissible for substantive purposes. Subsequent cases, *Flewallen v. State*² and *Samuels v. State*,³ raised questions as to the type of prior statements that will be substantively admissible. The scope of this Note is to review the background of *Patterson*, to examine the *Patterson* decision and the confusing line of cases which has followed in its wake, and to analyze the current status and probable future direction of the substantive use of prior statements in Indiana.

II. THE ORTHODOX VIEW AND ITS CRITICS

In the earliest reported cases, there seemed to be no question that prior statements were admissible as substantive evidence.⁴ This view was not abandoned until the nineteenth century.⁵ It was replaced by what Dean Wigmore termed the "orthodox view"⁶ that prior statements are not admissible as substantive evidence of the facts stated therein. So dominant was the rule⁷ that in 1944 the Appellate Court of Indiana stated: "Under no principle of the law of evidence, of which we have knowledge or to which we have been referred, can such testimony [prior statements] be considered substantive evidence . . .".⁸

Commentators and case law recognize three reasons for supporting the orthodox view which denies substantive evidential use of prior statements: (1) The prior statement was not made under oath

¹263 Ind. 55, 324 N.E.2d 482 (1975).

²368 N.E.2d 239 (Ind. 1977).

³372 N.E.2d 1186 (Ind. 1978).

⁴Annot., 140 A.L.R. 21, 22 (1942).

⁵*Id.*

⁶A J. WIGMORE, EVIDENCE § 1018, at 998 (Chadbourn rev. ed. 1970). See also Annot., 133 A.L.R. 1454 (1941).

⁷See 98 C.J.S. Witnesses § 628 (1957).

⁸Lee Bros., Inc. v. Jones, 114 Ind. App. 688, 714, 54 N.E.2d 108, 118 (1944).

and therefore is not subject to the penalty for perjury, (2) the statement was not made before the trier of fact who could observe the declarant's demeanor in judging the credibility of the statement, and (3) when the prior statement was made, it was not subject to rigorous testing of its truthfulness by cross-examination.⁹

Despite the broad acceptance of the orthodox view among the nation's courts,¹⁰ it was criticized by prominent commentators. Among the earliest questioners of the majority position were Judge Learned Hand and Dean Wigmore.¹¹

Judge Hand's oft-quoted statement in the 1925 decision of *DiCarlo v. United States*¹² anticipated the view which many legal thinkers would later adopt:

The possibility that the jury may accept as the truth the earlier statements in preference to those made upon the stand is indeed real, but we find no difficulty in it. If, from all that the jury see of the witness, they conclude that what he says now is not the truth, but what he said before, they are none the less deciding from what they see and hear of that person and in court. There is no mythical necessity that the case must be decided only in accordance with the truth of words uttered under oath in court.¹³

Unlike followers of the orthodox rule, Judge Hand emphasized the conditions under which the prior statement is presented to the jury, not the conditions under which the statement was originally uttered.

Dean Wigmore initially supported the orthodox position but later converted to favoring substantive use of prior statements.¹⁴ Wigmore found that the reason for excluding prior statements—the non-availability of the declarant for cross-examination—was cured by the declarant's later presence in court where he could be ade-

⁹See *California v. Green*, 399 U.S. 149 (1970); *Beavers v. State*, 492 P.2d 88 (Alaska 1971); *Harvey v. State*, 256 Ind. 473, 269 N.E.2d 759 (1971); *Jett v. Commonwealth*, 436 S.W.2d 788 (Ky. 1969); *Gelhaar v. State*, 41 Wis. 2d 230, 163 N.W.2d 609 (1969), cert. denied, 399 U.S. 929 (1970); MCCORMICK'S HANDBOOK ON THE LAW OF EVIDENCE § 245 (2d ed., E. Cleary 1972) [hereinafter cited as MCCORMICK'S HANDBOOK]. See also FED. R. EVID. 801(d) (Advisory Committee's Note); Beaver & Biggs, *Attending Witnesses' Prior Declarations as Evidence: Theory vs. Reality*, 3 IND. LEGAL F. 309 (1970).

¹⁰See 98 C.J.S. *Witnesses* § 628 (1957).

¹¹These scholars were described by Professor Charles McCormick as "the greatest judge of our day and . . . the greatest legal writer in our history." McCormick, *The Turncoat Witness: Previous Statements as Substantive Evidence*, 25 TEX. L. REV. 573, 583 (1947).

¹²6 F.2d 364 (2d Cir. 1925).

¹³Id. at 368.

¹⁴3A J. WIGMORE, *supra* note 6, § 1018.

quately cross-examined as to the basis for his prior remarks.¹⁵ Additionally, Wigmore found an out-of-court statement could be just as useful as one made before a tribunal: "Psychologically of course, the one statement is as useful to consider as the other; and everyday experience outside of courtrooms is in accord."¹⁶

Professor McCormick added his prominent voice to those favoring substantive use of prior statements.¹⁷ McCormick criticized the theory of accepting a statement for one purpose—impeachment—and not for another—substantive use. Its value in either case depends on the ability of the jury to give it some credibility:¹⁸

Unless the statement *may* be true, it does not have the effect of shaking the credibility of the testimony; and that it *may* be true is about all one means by accepting a statement as evidence of its truth. The notion that the judge and the jury may only say, "We know not which story is true; we only say that the witness blows hot and cold, and hence is not to be believed in either," demands a finical neutrality alien to the atmosphere of jury trial.

. . . The argument seems persuasive that if the previous statement and the circumstances surrounding its making are sufficiently probative to empower the jury to disbelieve the story of the witness on the stand, they should be sufficient to warrant the jury in believing the statement itself.¹⁹

Indeed, McCormick found that prior statements were generally more trustworthy than later testimony because the declarant's memory was presumably fuller and fresher.²⁰ McCormick emphasized that "memory hinges on recency,"²¹ and that "the time element plays an important part, always favoring the earlier statement."²²

Professor Edmund M. Morgan also joined those favoring substantive use of prior statements.²³ He found that the safeguards of trustworthiness were adequate when out-of-court declarants were in court and subject to full cross-examination.²⁴

The debate over substantive use of prior statements has

¹⁵*Id.*

¹⁶*Id.* at 996.

¹⁷MCCORMICK'S HANDBOOK, *supra* note 9, § 251; McCormick, *supra* note 11.

¹⁸McCormick, *supra* note 11, at 581.

¹⁹*Id.* at 581-82.

²⁰*Id.* at 577.

²¹*Id.*

²²*Id.* at 578.

²³Morgan, *Hearsay Dangers and the Application of the Hearsay Concept*, 62 HARV. L. REV. 177, 195-96 (1948).

²⁴*Id.*

centered on the adequacy of later cross-examination.²⁵ Can cross-examination delayed by weeks or months truly test truthfulness and accuracy to the same extent as immediate probing by an opponent? And, in the case of prior inconsistent statements, can there ever be effective cross-examination?

The two classic defenses of the orthodox view—stated in *State v. Saporen*²⁶ and *Ruhala v. Roby*²⁷—focused on the deficiencies inherent in this type of “post-mortem” cross-examination.²⁸ These deficiencies were viewed so seriously in a later case²⁹ that the substantive use of prior statements was found to violate the confrontation clause of the United States Constitution.³⁰

The defense of the orthodox rule in *Saporen* summarized in eloquent terms the position that after-the-fact cross-examination simply was not adequate:

Its [cross-examination] principal virtue is in its immediate application of the testing process. Its strokes fall while the iron is hot. False testimony is apt to harden and become unyielding to the blows of truth in proportion as the witness has opportunity for reconsideration and influence by the suggestions of others, whose interest may be, and often is, to maintain falsehood rather than truth.³¹

The court stated that a substantive use rule would increase the temptation to manufacture evidence, allow the use of declarations extracted by harsh means, and enhance the opportunity to entrap witnesses.³²

In *Ruhala*, the Michigan Supreme Court took great pains to demonstrate how substantive use of prior inconsistent statements shackled effective cross-examination. Using a hypothetical cross-examination, it illustrated that under the substantive use view, a

²⁵McCORMICK'S HANDBOOK, *supra* note 9, § 251; Beaver & Biggs, *supra* note 9; Falknor, *The Hearsay Rule and Its Exceptions*, 2 U.C.L.A. L. REV. 43 (1954); Graham, *Employing Inconsistent Statements for Impeachment and as Substantive Evidence: A Critical Review and Proposed Amendments of Federal Rules of Evidence 801(d)(1)(A), 613 and 607*, 75 MICH. L. REV. 1565 (1977).

²⁶205 Minn. 358, 285 N.W. 898 (1939).

²⁷379 Mich. 102, 150 N.W.2d 146 (1967).

²⁸The orthodox rule in Minnesota was recently overruled by the adoption of MINN. R. EVID. 801, while the orthodox rule in Michigan was recently modified with regard to statements of identification by adoption of MICH. R. EVID. 801.

²⁹People v. Johnson, 69 Cal. 2d 646, 655-56, 441 P.2d 111, 120-21, 68 Cal. Rptr. 599, 608-09 (1968), cert. denied, 393 U.S. 1051 (1969), overruled by California v. Green, 399 U.S. 149 (1970).

³⁰“In all criminal prosecutions, the accused shall enjoy the right . . . to be confronted with the witnesses against him” U.S. CONST. amend. VI.

³¹205 Minn. at 367, 285 N.W. at 901.

³²*Id.*

witness could never totally recant his prior statement.³³ Instead of destroying a witness' credibility, the challenging attorney is left to "windmill fighting No matter how deadly the thrust of the cross-examiner, the ghost of the prior statement stands. His questions will always sound like attempts to permit the witness to explain *why* he changed his story before coming to court"³⁴

Critics of the orthodox view were not convinced.³⁵ McCormick responded that the use of prior statements opened another avenue to truth, the finding of which was the very reason for the practice of cross-examination.³⁶ Morgan questioned why falsehood would harden

³³The hypothetical included the following:

Q. William, you say that the man had to have been driving, is that right?

A. Yes.

Q. Did you see the man behind the wheel before the accident?

A. No.

....

Q. Isn't it possible that the man was thrown out of the car from the passenger's side and the woman was thrown across the front seat from the driver's seat?

A. Yes, that's possible.

Q. *Do you still say that the man had to have been driving?*

A. *No, I guess not.*

Now let us see whether the stale cross-examination of Burditt "*with respect to*" his statement, as envisioned by the Uniform Rule and advocated by Professor McCormick, would have the same effect:

....

Q. Isn't it possible that the man was thrown out of the car from the passenger's side and the woman was thrown across the front seat from the driver's side?

A. Yes, that's possible.

At this point, the cross-examiner is stymied. The crucial question which would give the witness a chance to change his story, "*Do you still say that the man had to have been driving?*" is meaningless. The witness has already testified that he is not still saying that the man had to have been driving. Instead of a plunge to the jugular, the examiner will have to be satisfied with applying a bandage. It would sound something like this:

Q. And isn't this the reason why the story you are telling us today is different from the story you told the police officer?

379 Mich. at 125-28, 150 N.W.2d at 157-58.

³⁴*Id.* at 128, 150 N.W.2d at 158.

³⁵Professor McCormick offered a point-by-point counterargument to Judge Stone opinion, McCormick, *supra* note 11, at 586-87.

³⁶Too often the cross-examiner of a dubious witness is faced by a smooth, blank wall. The witness has been able throughout to present a narrative which may be false, yet is consistent with itself and offers no foothold for the climber who would look beyond. But the witness who has told one story aforetime and another today has opened the gates to all the vistas of truth which the common law practice of cross-examination and re-examination was invented to explore.

Id. at 576-77.

any quicker than truth, and why delay would tend to cultivate corruptive influences rather than truthful ones.³⁷ The *Ruhala* court's dramatic view of cross-examination was also attacked for assuming that the opposing counsel will be able to destroy a witness "á la Perry Mason,"³⁸ an unlikely result in a jury trial free from script writers.

Possibly the orthodox rule's greatest weakness is the necessity for a limiting instruction to the jury.³⁹ Under the orthodox view, a witness' prior inconsistent statement is admissible for impeachment purposes. When such a statement is admitted, the jury is to be instructed that use of such evidence is limited to impeachment purposes.⁴⁰ It may not be used as substantive proof of the facts stated therein.

Scholars are nearly united in their belief that such an instruction is either not understood or not complied with by jurors.⁴¹ McCormick termed such an instruction a "verbal ritual."⁴² Rather than being computer-like machines, jurors gather impressions from all that goes on at the trial and make their decisions based upon those overall impressions.⁴³

Defenses of the orthodox view—specifically the *Saporen* and *Ruhala* opinions—have not attempted to defend the actual effect, or lack thereof, of the limiting instruction. Professor Falknor, however, accepting the need for some use of the limiting instruction, admitted its shortcomings but contended there was "no other rational solution."⁴⁴

The substantive use view has been criticized on grounds other than inadequate cross-examination. Beaver and Biggs⁴⁵ found poten-

³⁷Morgan, *Hearsay Dangers and the Application of the Hearsay Concept*, 62 HARV. L. REV. 177 (1948).

³⁸Graham, *supra* note 25, at 1571.

³⁹Beaver & Biggs, *supra* note 9.

⁴⁰McCORMICK'S HANDBOOK, *supra* note 9, § 251 n.62.

⁴¹See M. SEIDMAN, THE LAW OF EVIDENCE IN INDIANA (1977); Beaver & Biggs, *supra* note 9; McCormick, *supra* note 11. See also Annot., 133 A.L.R. 1454 (1941).

⁴²McCormick, *supra* note 11, at 580.

⁴³It stands to reason that jurors normally reach a decision as a spontaneous reaction to the entire mass of incidents at the trial as a whole, including the comportment of the witnesses, of the court, of the parties and of counsel. Perhaps they could not, and it seems that they do not, add each item of evidence to the scales of their deliberation, assigning to each item its own appropriate and due legal value, thence reaching a verdict by observing to which side the scales trip. Verdicts are not reached in any such manner; they are not attained by voluntary process, controllable with the precision of scientific instruments.

McCormick, *supra* note 9, at 321-22. See Annot., 133 A.L.R. 1454, 1466 (1941).

⁴⁴Falknor, *supra* note 25, at 54.

⁴⁵Beaver & Biggs, *supra* note 9, at 315.

tial practical drawbacks in the doctrine's application such as manufactured evidence and increased perjury, greater confusion, and increased consumption of trial time.⁴⁶ Apparently, these problems have not materialized to any great degree as evidenced by the increasing number of states turning to the substantive use view.⁴⁷

Various proposals have been advanced by those favoring substantive use. The different proposals reflect an effort to balance sufficient assurances that the prior statement was trustworthy against the desirability of getting all relevant information before the jury.⁴⁸

The American Law Institute's Model Code of Evidence, published in 1942, called for abolishing all barriers established by the orthodox rule.⁴⁹ All prior statements were to be substantively admissible whether they were consistent or inconsistent without regard to the circumstances under which they were made. The Model Code required only that the declarant be in court and subject to cross-examination, or be unavailable. The declarant's later presence in court would be an adequate basis upon which the jury could judge the credibility of the declarant's earlier statement.⁵⁰

The Uniform Rules of Evidence, proposed in 1953,⁵¹ solidly favored substantive use of prior statements, but only statements made by declarants present and subject to cross-examination were to be admissible.⁵² The statement had to be one which would have been admissible if the declarant had made it while testifying as a witness. Again, no distinctions were made between consistent and inconsistent statements.

⁴⁶*Id.*

⁴⁷See notes 165 & 173 *infra*.

⁴⁸See generally Graham, *supra* note 25.

⁴⁹"Evidence of a hearsay declaration is admissible if the judge finds that the declarant (a) is unavailable as a witness, or (b) is present and subject to cross-examination." MODEL CODE OF EVIDENCE Rule 503 (1942).

⁵⁰*Id.*, Comment b to Rule 503.

⁵¹The proposed rules were later superseded by UNIFORM RULES OF EVIDENCE, adopted by the National Conference of Commissioners on Uniform State Laws in 1974.

⁵² Evidence of a statement which is made other than by a witness while testifying at the hearing offered to prove the truth of the matter stated is hearsay evidence and inadmissible except: (1) Previous Statements of Persons Present and Subject to Cross Examination. A statement previously made by a person who is present at the hearing and available for cross-examination with respect to the statement and its subject matter, provided the statement would be admissible if made by declarant while testifying as a witness.

UNIFORM RULES OF EVIDENCE 63(1), *reprinted in* 4 S. GARD, JONES ON EVIDENCE 413 (6th ed. 1972).

McCormick's proposed rule,⁵³ however, drew distinctions between types of prior statements but on a different basis than consistency. He found witnesses' memories of oral statements to be "peculiarly faulty and fleeting."⁵⁴ The risk of mistransmission was greater than the probative value of such evidence. McCormick's rule required the prior statement be a signed or written statement, or testimony, or an unsworn oral statement which the declarant later acknowledges while testifying. Also, the rule required the declarant be in court and subject to cross-examination. Professor Falknor supported the McCormick rule with the additional provision that the declarant's statement refer to events or conditions which the declarant had an adequate opportunity to perceive.⁵⁵

III. SHIFT TO THE SUBSTANTIVE USE VIEW

Although the substantive use theory enjoyed wide support among commentators, its adoption in actual practice was quite limited until 1969.⁵⁶ Substantial acceptance began with two legal landmarks—the United States Supreme Court decision of *California v. Green*,⁵⁷ and the proposal and later adoption of the Federal Rules of Evidence.⁵⁸

Green cleared the constitutional path for the substantive use of prior statements when the declarant was in court, available for cross-examination. In doing so, it rejected the California Supreme Court's holding that such use in a criminal case violated the defendant's constitutional right of confrontation.⁵⁹ In *Green* a declarant stated in a preliminary hearing that the defendant was his supplier of marijuana. At trial, the declarant changed his testimony and denied that Green had given him the illicit substance. Over objec-

⁵³ A statement made on a former occasion by a declarant having an opportunity to observe the facts stated, will be received as evidence of such facts, notwithstanding the rule against hearsay if

(1) the statement is proved to have been written or signed by the declarant, or to have been given by him as testimony in a judicial or official hearing, or the making of the statement is acknowledged by the declarant in this testimony in the present proceeding, and

(2) the party against whom the statement is offered is afforded an opportunity to cross-examine the declarant.

McCormick, *supra* note 13, at 588.

⁵⁴*Id.*

⁵⁵Falknor, note 25 *supra*.

⁵⁶The jurisdictions accepting substantive use of prior statements were limited to Alaska, *Hobbs v. State*, 359 P.2d 956 (Alaska 1961); California, CAL. EVID. CODE §§ 1235-36; New Jersey, N.J. R. EVID. 63(1).

⁵⁷399 U.S. 149 (1970).

⁵⁸FED. R. EVID. (1976).

⁵⁹399 U.S. at 150-51, *overruling* *People v. Johnson*, 68 Cal. 2d 646, 441 P.2d 111, 68 Cal. Rptr. 599 (1968), *cert. denied*, 393 U.S. 1051 (1969).

tions, the declarant's prior inconsistent statement was admitted as substantive evidence.

While recognizing the similarity in the values protected by the sixth amendment and the hearsay rule, the Court held they were not synonymous; if the declarant is available *in court to be cross-examined* as to his prior inconsistent statement, no constitutional right is infringed.⁶⁰

The second major development accepting the substantive use of prior statements was the adoption of Federal Rules of Evidence, initially proposed in 1969⁶¹ with a revised draft published in 1971.⁶² The rules were finally passed into law by Congress effective July 1, 1975.⁶³

Proposed Rule 801(d)(1) provided that if the declarant testified at trial and was subject to cross-examination, *all* his prior *inconsistent* statements were admissible for substantive use. Prior *consistent* statements could be used substantively only after the declarant had been challenged, expressly or impliedly, on the grounds of recent fabrication or improper motive.⁶⁴

The Advisory Committee commented that use of prior statements was a controversial area. With regard to prior inconsistent statements, the committee found that the traditional reasons for withholding such statements from substantive consideration—lack of oath, demeanor observation, and cross-examination—were not so significant as to merit the loss of the evidence.⁶⁵

In noting the more restrictive position on prior consistent statements, the Advisory Committee stated it was "unwill[ing] to countenance the general use of prior prepared statements as substantive evidence."⁶⁶ On the other hand, if opposing counsel wished to open the door to the substantive use of prior consistent statements by challenging the declarant's credibility, no reason existed why he should not be free to do so.⁶⁷

Congress amended the proposed rules before their adoption.⁶⁸

⁶⁰399 U.S. at 159.

⁶¹PRELIMINARY DRAFT OF PROPOSED RULES OF EVIDENCE FOR THE UNITED STATES DISTRICT COURTS AND MAGISTRATES, 46 F.R.D. 161 (1969).

⁶²REVISED DRAFT OF PROPOSED RULES OF EVIDENCE FOR THE UNITED STATES COURTS AND MAGISTRATES, 51 F.R.D. 315 (1971) [hereinafter cited as PROPOSED FED. R. EVID. (1971 draft)].

⁶³Fed. R. Evid., Pub. L. No. 93-595, 88 Stat. 1926 (codified at 28 U.S.C. app. at 539, 605 (1975)).

⁶⁴PROPOSED FED. R. EVID. 801(d)(1) (1971 draft), *supra* note 62.

⁶⁵*Id.* Advisory Committee Note at 575-76.

⁶⁶*Id.* at 576.

⁶⁷*Id.*

⁶⁸For a general discussion of the reasons leading to the change in the PROPOSED FED. R. EVID. 801 (1971 draft) *supra* note 63, see Ordover, *Surprise! That Damaging*

The final version of Federal Rule of Evidence 801⁶⁹ contains a greatly restricted provision on the substantive use of prior inconsistent statements, admitting them only if made under oath at a trial or other judicial proceeding.

The rule carried McCormick's doubt about admitting prior oral statements⁷⁰ an extra step. Congress required the solemnity of an oath and a judicial type of proceeding before a statement would be sufficiently trustworthy for substantive admission.

Congress has been criticized for changing the proposed rule.⁷¹ At least one scholar proposed an amendment to rule 801;⁷² however, it has not been changed since its enactment.

IV. INDIANA'S ADOPTION OF THE SUBSTANTIVE USE VIEW

As in other jurisdictions, the orthodox view was deeply entrenched in Indiana.⁷³ As early as 1884, the Indiana Supreme Court made clear that prior inconsistent statements were admissible only for impeachment purposes.⁷⁴

The sometimes decisive effect of the orthodox view was graphically shown in the Indiana Supreme Court case of *McAdams v. State*.⁷⁵ In that burglary case, McAdam's wife and son were called to testify by the prosecution. Both denied that the defendant had made incriminating statements to them. The witnesses' prior written inconsistent statements were introduced for impeachment purposes only, and a conviction followed. The only other evidence against McAdams was the discovery of a stolen brown jar in McAdams' house and the defendant's flight to another county. The supreme court held that, without the prior statements as substan-

Turncoat Witness Is Still With Us: An Analysis of Federal Rules of Evidence 607, 801(d)(1)(A) and 403, 5 HOFSTRA L. REV. 65 (1977).

⁶⁹(d) Statements which are not hearsay. A statement is not hearsay if—

(1) Prior statement by witness. The declarant testifies at the trial or hearing and is subject to cross-examination concerning the statement and the statement is (A) inconsistent with his testimony, and was given under oath subject to the penalty of perjury at a trial, hearing, or other proceeding, or in a deposition, or (B) consistent with his testimony and is offered to rebut an express or implied charge against him of recent fabrication or improper motive

FED. R. EVID. 801(d).

⁷⁰See note 54 *supra*.

⁷¹See M. SEIDMAN, *supra* note 41, at 35; Graham, *supra* note 25; Moore & Bendix, *Congress, Evidence and Rulemaking*, 84 YALE L.J. 9; Ordover, *supra* note 68; Stalmack, *Prior Inconsistent Statements: Congress Takes a Compromising Step Backwards in Enacting Rule 801(d)(1)(A)*, 8 LOY. CHI. L.J. 251 (1977).

⁷²Graham, *supra* note 25, at 1582-93.

⁷³30 I.L.E. *Witnesses* § 245.

⁷⁴Allen v. Davis, 101 Ind. 187 (1884).

⁷⁵226 Ind. 403, 81 N.E.2d 671 (1948).

tive evidence, there was insufficient evidence to sustain the guilty verdict.⁷⁶ The conviction was reversed.⁷⁷

The impact of the orthodox view was again shown in 1970 in *Glover v. State*,⁷⁸ a supreme court decision which overturned a second degree murder conviction because of insufficient evidence. The victim had been stabbed to death in an alley outside a tavern where earlier that evening the victim and a companion had been in an altercation with the defendant and the defendant's brother. Testimony placed the defendant in the vicinity of the tavern at about the time of the murder, but no physical evidence connected him to the crime.

At trial, the defendant's girlfriend testified that although she had observed a scuffle in the dark outside the tavern, she could not identify the participants. The court then admitted her grand jury testimony which positively identified the defendant as a participant in the fight. The majority held that the prior statement could not be used as substantive evidence, and therefore, there was no evidence linking the defendant to the crime.⁷⁹ This conviction also was reversed.⁸⁰

The dissent stated that the jury apparently believed that the witness, either from fear or friendship, was withholding the identity of the defendant in her testimony. The dissent asserted that the determination of witness credibility was for the jury.⁸¹

Five years after *Glover*, the orthodox view was swept aside by the landmark Indiana case of *Patterson v. State*.⁸² The Indiana Supreme Court made a clear pronouncement of its break from the orthodox view, stating that henceforth Indiana courts would accept the substantive use of prior statements.⁸³ The *Patterson* court's "clear" pronouncement, however, has been substantially clouded by holdings in subsequent cases.

In *Patterson*, an involuntary manslaughter case, two pretrial signed statements were given to police—one by Mrs. Patterson, the

⁷⁶*Id.* at 414, 81 N.E.2d at 676.

⁷⁷*Id.* at 415, 81 N.E.2d at 678.

⁷⁸253 Ind. 536, 255 N.E.2d 657 (1970) (3-2 decision) (Givan & Arterburn, JJ., dissenting).

⁷⁹*Id.* at 539-40, 255 N.E.2d at 659.

⁸⁰*Id.* at 540, 255 N.E.2d at 659.

⁸¹Justice Givan's dissenting opinion chided the majority opinion for not mentioning the prior positive identification before the grand jury. *Id.* at 540-41, 255 N.E.2d at 660 (Givan, J., dissenting).

⁸²263 Ind. 55, 324 N.E.2d 482 (1975).

⁸³"[T]he 'hearsay evidence' issue . . . is that issue that occasioned the grant of transfer, in hopes of making a clear pronouncement of our departure from an ancient application of the hearsay rule—one that we have more recently determined to be a misapplication." *Id.* at 56, 324 N.E.2d at 484.

defendant's wife, the other by Miss Robinson, a guest of the victim. Robinson testified for the prosecution. The defense attempted to impeach her by excerpts from her prior statement to police. The prosecution then introduced the entire statement into evidence. The statement was consistent with Robinson's earlier testimony, but was more detailed and therefore more incriminating. Mrs. Patterson's prior statement was also consistent with her testimony except for what the supreme court termed "one relatively minor aspect"⁸⁴ and it, too, was introduced into evidence by the prosecution.

In one paragraph, the supreme court upended the orthodox rule and held that prior statements could be used as substantive evidence. The court, in this paragraph, related a brief history of the orthodox rule in Indiana and stated the new holding; it discussed the views of commentators, the proposed uniform evidence codes, and the proposed and adopted Federal Rules of Evidence.⁸⁵ The court stated that both declarants were on the witness stand when the prior statements were offered, and that neither denied making or professed ignorance of the earlier statements. "It was, therefore, not necessary for the truth of the out-of-court assertions to rest upon the credibility of persons not present and then subject to cross-examination concerning the statements."⁸⁶

In its limited discussion, the court indicated that the view adopted by *Patterson* was in accord with but not as liberal as the views of McCormick, Wigmore, and the Uniform Rules of Evidence.⁸⁷ The opinion, however, failed to set out those rules, or detail how Indiana's rule would differ from them. Additionally, the opinion stressed that both the proposed and adopted Federal Rules of Evidence required the availability of the declarant for cross-examination for prior statements to be admissible: "It is our judgment that this safeguard is of paramount importance and is adequate."⁸⁸

The dissent⁸⁹ registered the classic objection to the substantive use view—that of an inadequate ability to effectively cross-examine the declarant.⁹⁰ Justice DeBruler found that later cross-examination would improperly center on the circumstances surrounding the making of the earlier statement, and not the truth of the statement itself.⁹¹

⁸⁴*Id.* at 57, 324 N.E.2d at 484.

⁸⁵*Id.* at 57-58, 324 N.E.2d at 484-85.

⁸⁶*Id.* at 58, 324 N.E.2d at 484.

⁸⁷*Id.*

⁸⁸*Id.* at 58, 324 N.E.2d at 485.

⁸⁹*Id.* at 64, 324 N.E.2d at 488 (DeBruler, J., dissenting).

⁹⁰See *Ruhala v. Roby*, 379 Mich. 102, 150 N.W.2d 146 (1967); *State v. Saporen*, 205 Minn. 358, 285 N.W. 898 (1939).

⁹¹263 Ind. at 65, 324 N.E.2d at 488.

Opinions in other states that have rejected the orthodox view by judicial decision provide an interesting contrast to the *Patterson* decision. Without exception, the reasoning in these cases is more detailed and provides specific guidelines as to which prior statements will henceforth be substantively admissible.

The Wisconsin Supreme Court overturned prior adherence to the orthodox position in *Gelhaar v. State*.⁹² In that case, statements were given to police by two children concerning an altercation between their parents which led to the father's stabbing death. The statements given by the children shortly after the event incriminated their mother to a much greater degree than did their testimony at trial.

In allowing the prior inconsistent statements as substantive evidence, the unanimous court opinion relied heavily upon McCormick's reasoning, quoting extensively from his writings.⁹³ It ruled that the presence of the declarant, under oath and subject to cross-examination in front of the jury, provided an adequate procedural safeguard to allow the substantive admission of prior inconsistent statements.⁹⁴ The court also noted that prior statements were nearer the event and, therefore, were subject to less distortion.⁹⁵ The court also doubted the effectiveness of the limiting instructions to the jury.⁹⁶

The *Gelhaar* holding set forth a specific rule,⁹⁷ adopting a modified version of the McCormick proposal.⁹⁸ The prior statement must have been written or signed by the declarant, or given as testimony, or acknowledged by the declarant while testifying. The declarant must be available for cross-examination. Finally, the substantive use is limited to prior inconsistent statements, specifically excluding prior consistent statements.⁹⁹

The Kentucky Supreme Court rejected the orthodox view in *Jett v. Commonwealth*.¹⁰⁰ Citing Professor Morgan, the Kentucky court discussed the orthodox view and decided there were sufficient safeguards when the declarant was present as a witness and subject to cross-examination.¹⁰¹ The reasoning of the Kentucky court's holding was less specific than that in *Gelhaar*; it did not address the

⁹²41 Wis. 2d 230, 163 N.W.2d 609 (1969), cert. denied, 399 U.S. 929 (1970).

⁹³*Id.* at 241, 163 N.W.2d at 613-14.

⁹⁴*Id.* 163, N.W.2d at 613.

⁹⁵*Id.*.

⁹⁶*Id.* at 239-40, 163 N.W.2d at 613.

⁹⁷*Id.* at 241-42, 163 N.W.2d at 614 (since superseded by WIS. R. EVID. 908:01(4)(a)).

⁹⁸See note 53 *supra*.

⁹⁹41 Wis. 2d at 241-42, 163 N.W.2d at 614.

¹⁰⁰436 S.W.2d 788 (Ky. 1969).

¹⁰¹*Id.* at 792.

issue of prior consistent statements and, as the case itself involved a prior oral statement given to police, it was clear the Kentucky rule did not impose the burden that the prior statement be under oath or in writing.

In *Beavers v. State*,¹⁰² the Alaska Supreme Court reaffirmed its position on the use of prior statements set out in *Hobbs v. State*.¹⁰³ The court in *Beavers* analyzed each of the reasons for the orthodox view, concluding that the rationale for the orthodox view does not stand up to critical scrutiny.¹⁰⁴ Instead of setting down specific rules for the admission of prior statements, however, *Beavers* followed *Hobbs*, stating that the admission of prior inconsistent statements as substantive evidence should be within the discretion of the trial judge.¹⁰⁵

North Dakota rejected the orthodox position in *State v. Igoe*,¹⁰⁶ which borrowed a rationale almost verbatim from the Advisory Committee Note to the proposed Federal Rule of Evidence 801(d) (1).¹⁰⁷ After extensively quoting with favor from the committee's note, the North Dakota Supreme Court stressed the desirability of rules which would be compatible with the federal system and adopted the proposed federal rule, at least as to the only issue involved, prior inconsistent statements.¹⁰⁸

The Arizona decision adopting the substantive use doctrine, *State v. Skinner*,¹⁰⁹ was decided the same year as *Igoe*. Like *Igoe*, *Skinner* also reflected the reasoning of the Advisory Committee Note, quoting extensively therefrom.¹¹⁰ Additionally relying on the rationale of *California v. Green*¹¹¹ and the reasoning of Judge Learned Hand,¹¹² the Arizona court decided it was futile for the trier of fact to attempt to consider prior inconsistent statements for impeachment but not for substantive proof of the facts stated therein.¹¹³

¹⁰²492 P.2d 88 (Alaska 1969).

¹⁰³359 P.2d 956 (Alaska 1961).

¹⁰⁴492 P.2d at 94.

¹⁰⁵*Id.*

¹⁰⁶206 N.W.2d 291 (N.D. 1973).

¹⁰⁷*Id.* at 294-96.

¹⁰⁸*Id.* at 297. North Dakota has since adopted N.D. R. EVID. 801(d) which is very similar to the adopted FED. R. EVID. 801(d).

¹⁰⁹110 Ariz. 135, 515 P.2d 880 (1973).

¹¹⁰*Id.* at 141-42, 515 P.2d at 886-87.

¹¹¹399 U.S. 149 (1970).

¹¹²110 Ariz. at 142, 515 P.2d at 887 (quoting *United States v. Allied Stevedoring Corp.*, 241 F.2d 925, 934 (2d Cir. 1957)).

¹¹³110 Ariz. at 142, 515 P.2d at 887. Arizona has now adopted ARIZ. R. EVID. 801(d), which is identical to proposed FED. R. EVID. 801(d) (1971 draft), *supra* note 63.

The West Virginia Supreme Court in *State v. Spadafore*¹¹⁴ rejected the orthodox rule in favor of Federal Rule of Evidence 801(d)(1), as adopted by Congress.¹¹⁵ The West Virginia court noted the scholarly criticisms of the orthodox view. It discussed the Federal Rules of Evidence, both as proposed and as adopted, and the view developed by Judge Friendly which allows for substantive use of prior trial and grand jury testimony.¹¹⁶ In requiring that prior statements be under oath, the court emphasized that there were special dangers in admitting *all* prior statements as substantive evidence.

While the Court recognizes that criminal defendants can often bring pressure to bear upon witnesses to compel a convenient loss of memory during the trial of a case, the sinister spectre of coerced statements made to the police in an *ex parte* manner is far more threatening. Frequently witnesses in criminal cases are implicated in the criminal activity at issue, . . . and the prosecutorial authorities can induce fear, a sense of guilt, and panic, in such a way as to cause distortion of the facts. In addition, out-of-court statements are subject to errors in transcription, outright misstatement by the officer preparing the statement for signature, and the errors of perception which are inherent in responses to leading questions.¹¹⁷

Each of these state decisions offered more detailed reasoning and clearer statements of the need to break with the orthodox view than did the *Patterson* decision. And each holding was more specific than the holding in *Patterson*, ranging from the very precise holdings in *Gelhaar*¹¹⁸ and *Spadafore*¹¹⁹ to a somewhat more general holding in *Jett*.¹²⁰

Despite the shortcomings of the *Patterson* decision, it clearly put Indiana in the substantive use camp. Within the same year, the Indiana Supreme Court relied on *Patterson* in affirming the denial of post conviction relief in *Torrence v. State*.¹²¹ Written by Justice DeBruler, who had dissented in *Patterson*, the opinion held that

¹¹⁴220 S.E.2d 655 (W. Va. 1975).

¹¹⁵*Id.* at 662-64.

¹¹⁶*Id.* at 661-64. See *United States v. De Sisto*, 329 F.2d 929, 932-34 (2d Cir.), *cert. denied*, 377 U.S. 979 (1964); *United States v. Kahaner*, 317 F.2d 459, 473-74 (2d Cir.), *cert. denied*, 375 U.S. 836 (1963).

¹¹⁷220 S.E.2d at 664.

¹¹⁸41 Wis. 2d 230, 163 N.W.2d 609 (1969).

¹¹⁹220 S.E.2d 655 (W. Va. 1975).

¹²⁰436 S.W.2d 788 (Ky. 1969).

¹²¹263 Ind. 202, 328 N.E.2d 214 (1975).

prior statements were admissible as substantive evidence despite the declarant's repudiation of them on the witness stand.¹²²

In the next year, in *Ortiz v. State*,¹²³ the supreme court approved the use of prior inconsistent statements, in affirming a first degree murder conviction. The prior statement was that of Ortiz' co-defendant Williams. The statement incriminated both Williams and Ortiz. On the stand, Williams denied the truth of the prior statement, but it was still admitted for substantive consideration. Despite the statement in *Patterson* that Indiana's rule was not as liberal as those of the commentators and of the proposed uniform evidence codes, the court cited *Patterson* for the rule that "extra-judicial statements are available as substantive evidence when the declarant is available at trial for cross-examination."¹²⁴ This position was the same as the Uniform Rules of Evidence,¹²⁵ and was more liberal than the McCormick position.¹²⁶

In April 1977, the supreme court, in *Carter v. State*,¹²⁷ specifically held that both prior oral and prior written statements could be substantively admissible. In *Carter*, the trial court erred in instructing the jury that a witness' prior written statement could be considered as substantive evidence, but a prior oral statement could be considered for impeachment only. Nevertheless, the supreme court affirmed the first degree murder conviction on the grounds that the error was harmless.

The *Carter* opinion incorporated the rule developed in *Patterson* and *Torrence*; if the declarant is available for in-court cross-examination, his prior statement is substantively admissible—be it consistent or inconsistent, oral or written.¹²⁸ This rule, however, that developed in Indiana from *Patterson* to *Carter* included none of the safeguards advocated by McCormick,¹²⁹ indeed, it seemed identical with the Uniform Rule of Evidence 63(1)¹³⁰ allowing the use of *any* prior statement when the declarant was available for cross-examination.

Professor Seidman in his treatise on Indiana evidence law¹³¹ praised the supreme court for its adoption of the substantive evidence position finding it identical with the *proposed Federal*

¹²²*Id.* at 205-06, 328 N.E.2d at 216.

¹²³356 N.E.2d 1188 (Ind. 1976).

¹²⁴*Id.* at 1194.

¹²⁵See note 52 *supra*.

¹²⁶See note 53 *supra*.

¹²⁷361 N.E.2d 1208 (Ind. 1977).

¹²⁸*Id.* at 1209-10.

¹²⁹See McCormick, *supra* note 11, at 588.

¹³⁰See note 52 *supra*.

¹³¹M. SEIDMAN, *supra* note 41.

Rules of Evidence,¹³² but Professor Seidman's remarks were limited to consideration of prior *inconsistent* statements.¹³³ The Indiana Supreme Court has expressed none of the concerns about prior *consistent* statements that were built into the proposed federal rules. The federal requirement that a witness first be challenged on the basis of recent fabrication or improper motive was not required by the Indiana court, as was dramatically illustrated in the key case of *Flewallen v. State*.¹³⁴

Flewallen appealed from a second degree murder conviction for the beating death of his eighteen-month-old stepdaughter. The trial court admitted several prior statements witnesses had made to police, the coroner, and the grand jury. The majority opinion summarized the nature of these statements: "Although there were some minor conflicts, most of the statements were consistent with the statements given by the witnesses on the stand, though the previous statements were more detailed in each case."¹³⁵

Justice DeBruler's dissent¹³⁶ provided a more specific analysis. Twelve statements were admitted—five had been given to police, one to the coroner, and six to the grand jury. The prior statements of two witnesses, were read to the jury only after they had testified about the events. The other four witnesses were asked to authenticate their prior statements *before* being asked any questions requiring a substantive response.¹³⁷

¹³²*Id.* at 34-35.

¹³³*Id.*

¹³⁴368 N.E.2d 239 (Ind. 1977).

¹³⁵*Id.* at 241.

¹³⁶*Id.* at 243 (DeBruler, J., dissenting).

¹³⁷The following excerpt from the record shows the extent of one witness' testimony prior to the introduction of her detailed prior statements given to police and the grand jury.

Q. Please state your full name to Judge Dietsch and the members of the Jury.

A. Golda Willis.

Q. Where do you live, ma'am?

A. 1304 Florence.

Q. In relation to 1310 Florence, could you tell us where that is on this sketch and you don't need to get down if you'll just let me indicate. This is the apartment of the Flewallen's.

A. Yes, sir.

Q. It has an "f" in the box?

A. Yes, sir.

Q. Could you tell us where . . .

A. I live the 3rd door from them.

Q. Which direction, ma'am, this way?

A. It would be going north.

Q. It has "G.W." in it right here. Is that your apartment?

The majority treated *Patterson* as dispositive of the issue.¹³⁸ Because the declarants were in court and subject to cross-examination, there was no violation of the confrontation clause;¹³⁹ their prior statements were admissible.¹⁴⁰

Justice DeBruler was not convinced. He characterized the prosecution's case as a "wholesale use of prior testimony and out-of-court statements of less than enthusiastic prosecution witnesses"¹⁴¹ and thus not within the scope of *California v. Green*; the United States Supreme Court had not given the states free reign to prosecute by prior statements when live in-court testimony was equally available.¹⁴² He concluded: "Permitting such evidence will cause criminal trials in this state to resemble trials in the English prerogative courts, whose reliance on *ex parte* affidavits to convict accused persons was a principal evil sought to be remedied by the constitutional guarantee of confrontation of one's accusers."¹⁴³ These concerns have been expressed by commentators who favor substantive use of prior statements.¹⁴⁴

It appears that only Kansas courts, have gone as far as *Flewallen* in admitting prior statements.¹⁴⁵ Prior statements were

A. Yes.

Q. Mrs. Willis, do you recall giving a statement to the Evansville Police Department on the 31st day of August, 1974?

A. Yes, sir.

Q. Do you have a copy of that with you?

WITNESS PRESENTS STATEMENT

Q. Mrs. Willis, I'm handing you what has been marked for purposes of identification as State's Exhibit No. 14. Would you tell us what that is, please? Not reading it, but do you recognize it?

A. Yes, sir, I do.

Q. Is that a statement which you gave on the 31st day of August, 1974?

A. Yes, sir.

Q. It has three pages?

A. Yes, sir.

Q. I'll show you what has been marked for purposes of identification as State's Exhibit No. 15, is that an accurate transcription to the best of your recollection of your Grand Jury testimony?

A. That's right.

MR. REDWINE: The State offers to introduce State's exhibits 14 and 15. Record at 443-44, *Flewallen v. State*, 368 N.E.2d 239 (Ind. 1977).

¹³⁸"This issue was decided by *Patterson v. State . . .*" 368 N.E.2d at 241.

¹³⁹*Id.* at 241 (citing *California v. Green*, 399 U.S. 149 (1970)).

¹⁴⁰368 N.E.2d at 241.

¹⁴¹*Id.* at 243.

¹⁴²*Id.*

¹⁴³*Id.* at 244.

¹⁴⁴See MCCORMICK'S HANDBOOK, *supra* note 9, at § 251; Falknor, *supra* note 25.

¹⁴⁵*State v. Taylor*, 217 Kan. 706, 538 P.2d 1375 (1975); *State v. Bagemehl*, 213 Kan. 210, 515 P.2d 1104 (1973); *State v. Jones*, 204 Kan. 719, 466 P.2d 283 (1970).

admitted under the Kansas statutory evidence rule¹⁴⁶ which required only that the declarant be available for cross-examination, and that the statement would have been admissible if it had been made by the declarant while testifying.

Illustrative of these Kansas cases is *State v. Jones*.¹⁴⁷ A step-father was convicted of the statutory rape of his seven-year-old step-daughter. The victim's maternal grandmother testified about statements made to her by the victim. The statement was made in the victim's hospital room ten days after the incident. The Kansas Supreme Court approved substantive use of the prior statement even though the girl was not in the courtroom at the time the grandmother testified. The court held the girl's presence in the judge's library was adequate availability, and because of her age and the emotional nature of the proceedings, she could be cross-examined largely by leading questions to which she could answer "yes" or "no". The Kansas Supreme Court found this to be adequate to allow the substantive use of the prior statement to which the grandmother testified.¹⁴⁸

Flewallen remained an undisputed statement of Indiana law for only five months. In March, 1978, in *Samuels v. State*,¹⁴⁹ the supreme court signaled a withdrawal from *Flewallen* and a possible rethinking of the *Patterson* decision.

The opinion in *Samuels* made it evident that *Flewallen* was not likely to be followed in future cases: "It appears that the rule drawn from *Patterson* may well be in need of reconsideration. To the extent that it has, on some occasions, been used to support the admission of out-of-court statements as a mere substitute for available in-court testimony, it has been misapplied."¹⁵⁰ Furthermore, the opinion suggested that the entire issue of substantive admission of prior statements may have been wrongly decided in *Patterson*.¹⁵¹ Thus, the supreme court appeared to seriously threaten the validity of any use of prior statements as substantive evidence. Yet there was no specific overruling or limiting of *Patterson*, nor did the opinion give

¹⁴⁶KAN. STAT. § 60-460 (Supp. 1977).

¹⁴⁷204 Kan. 719, 466 P.2d 283 (1970).

¹⁴⁸*Id.* at 729, 466 P.2d at 292. As a post-script to this case, the daughter was made a ward of the court following the natural mother's insistence that the stepfather would return to live with the mother and her daughter after the stepfather's release from prison. *In re Armentrout*, 207 Kan. 366, 485 P.2d 183 (1971).

¹⁴⁹372 N.E.2d 1186 (Ind. 1978).

¹⁵⁰*Id.* at 1187.

¹⁵¹"Whether or not the jury was entitled to consider them as substantive evidence, is another question—a question the defendant insists was erroneously decided in the *Patterson* case. Even assuming that *Patterson* was decided erroneously, however, the defendant has presented no error in his case." *Id.*

guidelines as to the supreme court's future course on substantive use other than that it was not likely to follow *Flewallen*. It appears that the court in *Samuels* wanted to signal a prompt withdrawal from the *Flewallen* position. Its entire discourse on the issue in *Samuels* was dicta. It need not have been included in the opinion since the substantive use challenge had been waived by the appellant's failures to request a limiting instruction from the trial court and to set out the specific error in his motion to correct errors.¹⁵²

V. PRIOR STATEMENTS: WHAT DIRECTION NOW?

The development of the law in other jurisdictions suggests that Indiana will not completely reject the *Patterson* substantive use position. Although several states have recently rejected the admission of prior statements for substantive use,¹⁵³ no state which has adopted the substantive use view later retreated entirely to the orthodox position.

A trio of 1978 Indiana Supreme Court cases appear to confirm that *Patterson* will not be rejected—*Rogers v. State*,¹⁵⁴ *Stone v. State*,¹⁵⁵ and *Williams v. State*.¹⁵⁶ All were the result of separate appeals by co-defendants found guilty of first degree murder at a joint trial. In each, the *Patterson*-type use of a prior statement as substantive evidence was approved.¹⁵⁷

The prior statement involved in the three cases was made by a co-defendant, James. James was also charged in the crime, but had entered a plea bargain agreement. At trial, James took the stand for the prosecution. He denied any knowledge of the shooting incident, and claimed his prior statements made to police and in open court at his sentencing were the result of police threats. The trial court permitted introduction of his prior statements as substantive evidence.

In *Rogers*,¹⁵⁸ the court did not make mention of the dispute over or reconsideration of *Patterson*. In a brief section, the opinion stated that the declarant was present and subject to cross-examination, therefore, the prior statement came within the *Patterson* rule and was substantively admissible.¹⁵⁹

¹⁵²*Id.*

¹⁵³See *State v. Burns*, 173 Conn. 317, 377 A.2d 1082 (1977); *Woodall v. State*, 235 Ga. 525, 221 S.E.2d 794 (1975); *People v. Gant*, 58 Ill. 2d 178, 317 N.E.2d 564 (1974); *State v. Granberry*, 491 S.W.2d 528 (Mo. 1973); *State v. Pope*, 287 N.C. 505, 215 S.E.2d 139 (1975); *Commonwealth v. Gee*, 467 Pa. 123, 354 A.2d 875 (1976).

¹⁵⁴375 N.E.2d 1089 (Ind. 1978).

¹⁵⁵377 N.E.2d 1372 (Ind. 1978).

¹⁵⁶379 N.E.2d 449 (Ind. 1978).

¹⁵⁷379 N.E.2d at 450, 377 N.E.2d at 1375, 375 N.E.2d at 1092.

¹⁵⁸375 N.E.2d 1089 (Ind. 1978).

¹⁵⁹*Id.* at 1092.

In *Stone*,¹⁶⁰ the majority opinion made an attempt to pull together the earlier cases and dispel some of the confusion. The opinion stated that *Patterson* and *Torrence* had opened the door for the substantive use of prior statements, but *Samuels* had warned against overextending that rule to allow prior statements as a substitute for live testimony.¹⁶¹ This case, the court held, was clearly one where substantive use of the prior statement was permissible: "The State brought forth the text of [the declarant's] statements only after he testified in a manner inconsistent with them, and therefore they were admissible in evidence under the *Patterson* rule as originally conceived."¹⁶² It must be noted, however, that *Patterson* dealt basically with prior consistent, not inconsistent, statements. *Williams*¹⁶³ disposed of virtually all its issues, including use of prior statements, by relying on the decisions in *Rogers* and *Stone*.¹⁶⁴

This trio of decisions indicates that the supreme court's desire to allow prior statements as substantive evidence survived *Samuels*. The basic premise that the safeguards for truth—oath, demeanor observation and cross-examination—are adequately protected when the declarant is available for cross-examination would seem fixed in Indiana law, at least with regard to prior inconsistent statements.

Although the current Indiana position is clearer than in the period immediately following the *Samuels* decision, exactly what types of prior statements are to be substantively admissible is still in doubt. Specifically, two issues remain unresolved: (1) What type of prior *inconsistent* statements will be admissible as substantive evidence?; and (2) under what conditions will prior *consistent* statements be admissible?

As to the first question, a substantial number of jurisdictions follow the Federal Rules of Evidence and require that prior inconsistent statements must be made under oath in a judicial type hearing in order to be admissible as substantive evidence.¹⁶⁵ The reasoning behind this rule is the susceptibility of non-judicial statements to mistransmission, and the possibility that they may have been made under pressure.¹⁶⁶

¹⁶⁰377 N.E.2d 1372 (Ind. 1978).

¹⁶¹*Id.* at 1375.

¹⁶²*Id.*

¹⁶³379 N.E.2d 449 (Ind. 1978).

¹⁶⁴*Id.* at 450.

¹⁶⁵State v. Spadafore, 220 S.E.2d 655 (W. Va. 1975); ARK. R. EVID. 801(d); ME. R. EVID. 801(d)(1); MINN. R. EVID. 801(d)(1); NEB. REV. STAT. § 6 27-801(4)(a) (1975); N.D. R. EVID. 801(d)(1).

¹⁶⁶See State v. Spadafore, 220 S.E.2d 655 (W. Va. 1975); MCCORMICK'S HANDBOOK, *supra* note 9, § 251.

It does not appear that Indiana will move in this direction, however. The *Carter* decision specifically stated there was no difference between prior oral and prior written statements for substantive purposes.¹⁶⁷ No subsequent Indiana decision has suggested an oath be required for substantive admissibility.

The second and more unsettled question is when will prior consistent statements properly be available for substantive use. The uncertainty that remains was illustrated by the recent Indiana Court of Appeals memorandum decision of *Boles v. State*.¹⁶⁸ In *Boles*, a witness was called to the stand and asked to identify her two prior statements made to police. The detailed statements were then read into evidence.¹⁶⁹ The witness was then questioned about the incident. These questions evoked answers consistent with, but more general in nature than the prior statements. After discussing *Flewallen*, the court commented that the supreme court in *dicta* had stated that prior statements could not be used as a mere substitute for live testimony. In upholding the substantive use of the statements involved, Judge Lybrook concluded:

Any reconsideration of the *Patterson* doctrine will have to come from the Supreme Court. It suffices here to say that Jordan's pretrial statements were not used as "mere substitutes" for available in-court testimony. The State not only read the statements to the jury but also elicited testimony from Jordan from the stand as to several particulars concerning the incident in question. Although the statements were more comprehensive than Jordan's trial testimony, they were not used as "mere substitutes."¹⁷⁰

The *Boles* opinion adopted a very limited interpretation of *Samuels'* mere substitution language, leaving any differing interpretation for future supreme court decisions. Under this interpretation, it appears an attorney could get a witness' prepared statement before the jury for substantive purposes by introducing the statement, then questioning the witness generally as to the matters stated therein.

The potential dangers in allowing unbridled use of prior consistent statements have been addressed both by the Advisory Committee to the Federal Rules of Evidence¹⁷¹ and by Professor McCormick.¹⁷² The Federal Rules of Evidence, McCormick's proposed rule, and the overwhelming number of states which have broken

¹⁶⁷361 N.E.2d 1208, 1210 (Ind.), *cert. denied*, 434 U.S. 866 (1977).

¹⁶⁸No. 1-877-A-187 (Ind. Ct. App. Sept. 7, 1978).

¹⁶⁹Record at 184-89.

¹⁷⁰No. 1-877-A-187 at 5.

¹⁷¹FED. R. EVID. 801(d).

¹⁷²See MCCORMICK'S HANDBOOK, *supra* note 9, § 251.

with the orthodox view allow substantive use of prior consistent statements only after the witness' credibility has been attacked.¹⁷³ This safeguard prevents the abuses and dangers of using prior prepared statements as evidence. But if opposing counsel wishes to open the door to such statements by attacking the witness' credibility, he may be allowed to do so.¹⁷⁴

One can only surmise what position will emerge in Indiana concerning prior consistent statements. Although, as noted in *Boles*, the changes in the *Patterson* rule must come from the Indiana Supreme Court. The better view would be that in order to prevent wholesale use of prepared testimony, prior consistent statements should be admissible as substantive evidence only when the credibility of the witness has been challenged. The adoption of the rule in Indiana would avoid the over-extension of the *Patterson* rule apparent in *Flewallen* and would provide a firm guideline for the state's legal profession.

VI. CONCLUSION

The Indiana Supreme Court in *Patterson* did not draw any distinctions between the emerging Indiana position and the positions of commentators and proposed uniform evidence codes. Its decision overruled the established orthodox rule and left in its place an imprecise rule allowing the substantive use of prior statements. This rule was overextended in *Flewallen*, causing a withdrawal from that position in *dictum* in *Samuels* only five months later. The decision in *Rogers* made clear that the Indiana Supreme Court will continue to allow the use of prior statements as substantive evidence. As to prior inconsistent statements, it seems apparent they will be admissible for substantive purposes regardless of whether they are written or oral, under oath or not. As to prior consistent statements, the issue is still in doubt, but the better rule would allow such statements in evidence only after the credibility of the witness had been challenged.

The law regarding prior statements and their use as substantive evidence in Indiana is clearer now than during the period following the *Samuels* decision. Nevertheless, three years after *Patterson*, there is less clarity about the specific Indiana rule than existed in many states in which the initial departure from the orthodox rule set forth more detailed guidelines for the substantive admission of prior statements.

STEPHEN M. TERRELL

¹⁷³ARIZ. R. EVID. 801; ARK. R. EVID. 801; CAL. EVID. CODE §§ 791 & 1236; FLA. STAT. ANN. § 90-801 (1979 Special Pamphlet); ME. R. EVID. 801; MINN. R. EVID. 801; NEB. REV. STAT. § 27-801; NEV. REV. STAT. § 51.035 (1973); N.M. STAT. ANN. § 20-4-801 (1970); N.D. R. EVID. 801; UTAH R. EVID. 63(1); WIS. STAT. ANN. § 908.01.

¹⁷⁴See PROPOSED FED. R. EVID. 801, Advisory Committee's Note; MCCORMICK'S HANDBOOK, *supra* note 9, § 251.

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